ASIA PACIFIC INITIATIVE

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VANCOUVER

AN INTERNATIONAL CENTRE FOR MARITIME COMMERCE

DECEMBER 1988

Prepared by
Jonathan Seymour & Associates
For
The Maritime Sub-Committee of
The Transportation Task Force
ASIA PACIFIC INITIATIVE

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February 7, 1989

Dr. Peter Lusztig
Chairman
Asia Pacific Initiative
Advisory Committee

Dear Dr. Lusztig:

The Transportation Task Force is pleased to present to members of the Advisory Committee a comprehensive report on the development of Vancouver as an International Centre for Maritime Commerce.

The Task Force began discussing this initiative in February, 1988. It concluded that one of the key steps to encourage the expansion of the marine services industry is the establishment and promotion of Vancouver as an attractive location for the commercial, operational and administrative control of internationally traded ships.

Terms of reference were established for a study which would:

- define the desirable attributes of a headquarters location for international shipping operations;
- assess the position of Canada, and specifically, of Vancouver, with respect to those attributes;
- identify the most likely candidates for relocation;
- recommend a strategic plan to attract those candidates; and
- project the costs and potential benefits to the economy from implementing the strategic plan.

The Task Force has worked closely with the consultant, Jonathan Seymour and Associates, in the preparation of this report and unanimously endorses its conclusions and recommendations.

The report concludes that there is a window of opportunity to attract international shipowners and managers to locate in Canada; and that the benefits to the Canadian economy - including some 1,600 jobs over three years - are substantial.

The study incorporated an extensive interview process with shipowners and senior shipping executives around the world. The results revealed an impressive amount of interest in Vancouver as a Pacific headquarters

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location, as long as an internationally competitive taxation environment could be established. Vancouver was perceived as an attractive place from which to conduct international shipping business and the logical location for an emergent maritime centre on this side of the Pacific.

Vancouver already has the essential attributes to become a centre for management of international maritime operations. To make this happen will require modification of Canadian tax policy to permit the "mind and management" of international shipping ventures to be located anywhere in Canada on a tax exempt basis. This is the central recommendation in the report and has the virtue of being non-regional in application. It is the wish of the Task Force that the Advisory Committee endorse this recommendation and forward it to Ministers as a key initiative in allowing British Columbia to reach its potential as a Pacific Centre for Canada.

Respectfully submitted,

Transportation Task Force
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PREFACE

ACKNOWLEDGEMENTS

The interview process involved wide ranging discussions with a large number of individuals associated with the shipping industry in Canada, the United States, Hong Kong and Europe. The consultants thank all those who gave so freely of their time, information and advice.

Grateful appreciation is due to the members of the Project Steering Committee of the Transportation Task Force, Asia Pacific Initiative for their advice and direction; with a particular acknowledgement of the part played by Professor Trevor Heaver who, in addition to his activity on the Steering Committee, undertook initial research in Asia.

The enthusiastic support and assistance of Linda Zia and Nancy Chau in generously sharing their many contacts in Hong Kong's shipping community, and in setting up valuable meetings, deserves special recognition and thanks.

REPORT STRUCTURE

This report is divided into three parts plus appendices.

Part 1 consists of a Background Note and the Executive Summary.

Part 2 reviews recent developments in international shipping, including ship registration, second registers, open registers, and the differing approaches adopted by various countries towards the international shipping industry through taxation and other policies. In addition to an emphasis on the traditional maritime countries in Europe, developments in North America, Hong Kong and several other maritime centres are considered.

Part 3 establishes the features of the business environment which an aspiring centre needs to offer the international shipping industry. Comparison with this ideal model indicates the areas where Vancouver compares well or poorly. Part 3 goes on to recommend action to address the shortfalls, to identify target groups, and to quantify the potential economic benefit which would likely accrue to Vancouver and British Columbia upon adoption of the recommendations.

CAVEAT

This report deals, on a "broad brush" basis, with the effects of taxation policies on the international shipping industry in a wide range of countries.

The complexity of the many national, comprehensive taxation systems involved, when applied to business conducted offshore, under varying degrees of residence, domicile, and double taxation treatment, necessarily requires prodigious simplification. There will be exceptions and variations in tax treatment at most levels, but these should not be allowed to detract attention from the aggregate direction and impact of the various taxation systems of the countries referred to in the report.

TERMS OF REFERENCE

VANCOUVER - AN INTERNATIONAL CENTRE FOR MARITIME COMMERCE

Prepare a comprehensive report on the potential to attract international ship management activities to Canada, and specifically to British Columbia, as a means to encourage the development of the marine services sector of the provincial economy.

A. Undertake a survey of trends and patterns of movement in the world-wide location of international shipping offices, ownership functions and management.

B. Undertake consultations with foreign and domestic shipping interests, including:

   1. Hong Kong based bulk carrier and liner owners looking for an attractive operating base as mainland reversion approaches.

   2. Scandinavian and European Owners unable to maintain national association because of high costs and restrictions on operating foreign-flag vessels from their national base.

   3. Established cruise ship operators considering a move away from high cost U.S. locations.

   4. American based-foreign flag tramp operators faced with changes in the American fiscal regime which may force them offshore.

   5. Canadian expatriate shipowners.

   6. Canadian exporters, charterers and organisations which have established shipping activities.

   Consult with various maritime associations and with the International Shipping Policy group within Transport Canada.

C. Develop a profile of the desirable attributes of a headquarters location for international shipowners/operators.

D. Provide an analysis of the attractions of a Vancouver location for foreign and domestic shipowning/operating functions.

E. Identify and evaluate the constraints in the Canadian and Vancouver environments which inhibit the establishment and growth of local functional management of foreign flag vessels.

F. Provide a realistic assessment of the significance of the constraints, identify the jurisdictions involved and the estimated costs of eliminating the constraints.

   A detailed analysis of the cost of taxes foregone through the introduction of tax relief measures is not required.

G. Describe the potential candidates for relocation and expansion, identify their particular requirements and assess the competitive position of Vancouver in relation to other shipping centres.

H. Recommend a strategic plan to address the constraints, enhance the favourable factors, and suggest the outline of marketing strategies to attract targeted organisations.

TABLE OF CONTENTS

		page
	Preface	i
	Terms of Reference	iii
PART ONE:	BACKGROUND & SUMMARY	
	Background	1
	Executive Summary	3
PART TWO:	INTERNATIONAL SHIPPING - A REVIEW	
1.	Ship Registration and Flag	29
2.	The Functions of Ship Ownership and Management	35
3.	Trends in World Shipowning	40
4.	A Comparison of Various Flag and Management Scenarios	47
5.	International Review - Europe	
5.1	The United Kingdom	53
5.2	Belgium	60
5.3	Denmark	61
5.4	France	62
5.5	Greece	63
5.6	Italy	66
5.7	The Netherlands	67
5.8	Spain	68
5.9	West Germany	69
5.10	Norway	71
5.11	Sweden	73
5.12	Other European Initiatives	74
6.	International Review - Hong Kong	75
7.	International Review - United States of America	92
8.	International Review - Other Centres	102
9.	International Review - Canada	106

PART THREE: THE INTERNATIONAL MARITIME CENTRE

1. The Interview Process 115

2. The Desirable Business Environment 116

3. Vancouver - Comparison of Attributes 119

4. The Spectrum of Ownership 135

5. Potential Target Groups 139

6. Economic Benefit 147

7. Recommendations 153

APPENDICES

I Trade Support and the Task Force on Deep-sea Shipping - April 1985 157

II The Taxation Model and Subsequent Comments 166

III Interview List 169

IV Interview Material/Questions 173

V Bibliography 177

VI Glossary 178

LIST OF TABLES, DIAGRAMS AND GRAPHS

Figure no.		page
1	international ship registers - basic conditions	33
2	options available to a shipowner through registry and crew selection	34
3	shipping company - bulk carrier operation possible departmental/functional division	38
4	major western flags - 1978 to 1987	41
5	open registers - 1978 to 1987	41
6	major flags; changes in dwt 1978 to 1987	42
7	beneficial ownership of FOC fleets	44
8	comparison of various flag and management scenarios	52
9/10	European fleets - flag composition 1982 and 1987	54/55
11	beneficial ownership - Greek nationals	64
12	the Greek controlled fleet by country of registration	65
13	Hong Kong - beneficially owned fleet 1988	80
14	Hong Kong - owned/managed fleet by flag	81
15	typical corporate structure - Hong Kong shipowner	88
16	the U.S. beneficially owned deep-sea fleet	93
17	the U.S. beneficially owned fleet by country of registration	94
18	fleet composition - Canadian control	107
19	Canadian-flag and Canadian controlled foreign-flag fleet (ocean-going) 1984 & 1987	108
20	comparative economic statistics	122
21	the spectrum of ownership	135
22	summary of short term estimated economic impacts	152
23	shipping centre development office - first year budget	156
24	implications of CIF vs FOB (WESTAC 1978)	164

PART 1

BACKGROUND

AND

EXECUTIVE SUMMARY

BACKGROUND

In spite of the importance of trade to its economy, Canada's involvement in international maritime commerce has been limited throughout the twentieth century.

The Canadian-flag fleet operating in the domestic trades on both coasts and in the Great Lakes, has been technically innovative and commercially successful. It compares favourably with the American competition. Concerns in the United States over the relative efficiency of this fleet was the main reason for the exclusion of maritime transportation from the Free Trade Agreement.

In the deep-sea trades, private ownership of Canadian-flag ships has been minimal. The only time when Canada has had a significant maritime presence was during two limited periods of direct government ownership. Between 1918 and 1923 under the Canadian Government Merchant Marine; and between 1942 and 1949 under the Park Steamship Company - a crown corporation formed to supervise the war-built ships owned by Canada. By 1948 the Park ships proved uncompetitive in private Canadian hands and were sold to foreign buyers.

Subsequent Canadian involvement in deep-sea international trade has been undertaken either by chartering foreign-flag ships, or by the ownership of foreign-flag ships through offshore subsidiaries. In the latter case, these ships have been managed outside Canada.

THE TASK FORCE ON DEEP-SEA SHIPPING

Suggestions that Canada should have a larger stake in international maritime commerce have recurred regularly since the Park ships were sold. In 1984, the Task Force on Deep-sea Shipping was formed under the chairmanship of Professor Gunnar K Sletmo to evaluate changing circumstances in the international shipping market; to see how these might detrimentally affect Canadian trading interests; and to recommend appropriate responses to these changes.

The Task Force reported to the Minister of Transport in April 1985. It recommended that the federal government take no steps towards establishing a core deep-sea fleet under Canadian-flag. It then went on to recommend that the government should create a fiscal environment conducive to establishing and maintaining international ship management activities in Canada. The vehicle proposed for this

initiative was designated an International Shipping Corporation (an ISC) which would be exempt from Canadian taxation. Stimulation of private activity in this manner was considered to be the most efficient and appropriate method of encouraging and strengthening Canada's expertise and interests in international shipping in support of the country's importing and exporting activities.

The ISC proposal received enthusiastic support from many sectors, including the Exporters Coalition on Canadian Maritime Policy, a group representing all of the major exporters in Canada.

The relevant recommendations of the Task Force, its reasoning, and comments on the strategic significance of maritime expertise in support of Canadian trade, are set out in Appendix I to this paper.

Consequent to the Task Force report, Clarkson Gordon was retained by Transport Canada to examine the technical aspects of the ISC proposal and to draft a taxation model and rules for discussion. The Clarkson Gordon Memorandum was very positive as to the ability to create a tax environment for ISCs which would be identifiable, secure, effective and would follow established precedent. Comments on the model were sought by Transport Canada and the Exporters Coalition submitted a detailed and pragmatic response. Further information on the model and the response is contained in Appendix II.

The ISC proposal failed to win the support and approval of the Ministry of Finance at that time. Since then other transport policy and legislative initiatives have taken priority, and the ISC proposal has received limited attention.

VANCOUVER - AN INTERNATIONAL CENTRE FOR MARITIME COMMERCE

EXECUTIVE SUMMARY

1. THE OBJECTIVE

Over the last twenty-five years Vancouver has grown into a substantial regional centre of maritime commerce. The city has the potential to become a major international maritime centre, but this potential remains unfulfilled - because Canadian ownership, management and control of ships engaged in international trade has not developed.

The 90 million tonnes of cargo shipped through Western Canadian ports generates an enormous demand for ocean transportation services - but few of these services are supplied or controlled by Canadian interests.

The objective of this study is to

* create an internationally competitive business environment suitable for the ownership, management and control of ships engaged in international trade; one which will

* permit Vancouver to achieve its natural potential as a major international centre for maritime commerce.

Canadian involvement in the supply of international shipping services is prevented by a limited number of constraints within the Canadian business environment. The primary constraint identified is the imposition of Canadian taxation at domestic rates on a sector which must compete in the international market place - where every other supplier operates in either a tax-free environment, or receives tax subsidies.

A fundamental restructuring is currently taking place in the national affiliations of international shipowners and ship managers. This change presents Vancouver with a unique window of opportunity.

The adjustment in the Canadian tax rules necessary to seize the opportunity will actually result in increased tax revenues, while generating substantial economic benefit through new jobs and income, and by the enhancement of Canadian trade. Elimination of the tax constraint will ensure that Vancouver has the right business environment to stimulate private sector international shipping activity.

2. THE BENEFITS

The initiative will generate substantial economic benefits in Canada by expanding employment and generating income through:

* growth in shipowning, ship management and the marine services sector
* international business centre development
* enhanced opportunities for trade

Only the shipping management and marine services benefits are quantified in the report. The trade and business centre development aspects will also create economic benefit and generate multiplier effects through the economy.

2.1 THE MARITIME SECTOR

The beneficiaries of the increased employment opportunity in the maritime sector will be in the skilled white-collar, managerial and professional groups.

* new jobs in shipowning and ship management (800 jobs - short term)
* expanded opportunities and additional jobs in the maritime services sector (200 jobs), and
* more indirect income and employment (600 jobs).

2.2 INTERNATIONAL BUSINESS CENTRE DEVELOPMENT

International shipping is a major element in international commerce. Established business centres such as London, New York, and Tokyo have large commercial maritime sectors which service trade. Newer and aspiring international business centres such as Hong Kong, Singapore, and Bermuda view the international maritime sector as fundamental to their development.

* Expansion of Vancouver's international maritime activity will compliment and support the growing international trade, banking, finance, and communications sectors. It will assist in achieving Vancouver's aspirations as a comprehensive international business centre and Canada's Asia/Pacific gateway.

2.3 TRADE

Easier access to in-depth shipping expertise will allow Canadian exporters and importers greater strategic control of commodity logistics, improving market positioning and minimizing the landed cost of their products.

* Canadian industry will become more competitive, promoting growth in trade.

3. ECONOMIC BENEFITS - QUANTIFIED

3.1 SHORT/MEDIUM TERM BENEFITS

A reasonable, short term estimate (year 3) of the economic impact of the initiative is 1,600 Vancouver-based full time jobs, generating a payroll income of $60 million, on local revenues of $180 million (expenditure on domestic goods and services) in the year.

The numbers are projected on the basis of between six and twelve shipowners/managers locating to Vancouver in the short term. The group will be a mixed one, containing various sizes and types of shipowner and having a controlled fleet of some 200 ships in aggregate.

The short term impact on employment is forecast at:

* direct employment	800 jobs
* indirect and imputed employment	
* marine services	200 jobs
* others	600 jobs
* total employment	1,600 jobs

Depending on mix, the 200-ship fleet would probably represent a capital stock of US$ 2 billion. On this basis, Aggregate earnings from freight and hire would approach an annual cashflow of US$ 1 billion. The short term economic benefit quantified above assumes, however, that ship financing remains offshore, and that gross earnings are not remitted to Canada; if they were - then the economic impact would increase.

3.2 MEDIUM/LONG TERM BENEFIT

Experience at other centres suggests that there is a "critical mass" in the development process. Once this threshold point is reached, additional shipowners, charterers and maritime service functions will establish major branches or relocate - simply because they cannot afford to be excluded as the market opportunities associated with the centre expand. Hong Kong and Greenwich, Connecticut, are good current examples. In both cases, marine companies continue to move in after some of the original reasons for the creation of the centre have disappeared.

Once the critical point is reached, the economic impact increases dramatically. Employment in the marine services sector is the main beneficiary.

* In both London and Hong Kong it is estimated that there is one person employed in the maritime services sector for each person employed by a shipowner/manager, accordingly:

  the medium term (5/10 years) prospects for Vancouver are exceptional.

For example, Hong Kong shipowners own and control some 1,000 ships. It has been estimated that direct local employment is between 8,000 and 10,000 people, whilst a total of some 20,000 people are employed in the colony in the combined marine and marine services sector.

In addition to general business services, e.g. legal, accounting, banking, and communications, the shipping community does business with, or through, a wide range of specialist marine services, including:

* chartering and S&P (sale and purchase) broking
* ship financing and investment services
* marine insurance broking
* claims adjustment
* marine surveyors
* admiralty lawyers
* arbitration centres
* naval architects and designers
* engineering consultants
* weather routing services
* specialist publications
* classification societies
* registration offices
* representatives/suppliers of spare parts, stores and ship repair

4. THE MAIN CONSTRAINT

The study has established the essential ingredients of a successful international maritime centre. The Vancouver business environment compares very favourably in most respects, with one significant exception:

* The overwhelming constraint which prevents Vancouver from becoming a major international shipping centre is the hostile and internationally uncompetitive taxation environment.

In most maritime countries, companies engaged in international shipping receive preferential tax treatment. Extensive capital allowances and grants on ships registered under the national flag have been widely used to reduce, and often eliminate, the tax bite, and to encourage investment in shipping. In addition -

* Many countries effectively treat the earnings derived from foreign-flag ships owned by offshore subsidiaries as tax exempt. The exemption continues to apply even when the shipping activities of an offshore subsidiary are controlled onshore by a managing agent owned by the parent company.

In comparison, the Canadian taxation position is much more onerous. Revenue Canada applies the so-called "mind and management" test to international shipping activities which have a Canadian presence. Consequently -

* If the "mind and management" (the active commercial control) of the international shipping activity is judged to reside in Canada, the worldwide income of the organisation is subject to Canadian taxation - irrespective of source.

The results of this unfavourable and internationally uncompetitive tax treatment are predictable:

* Canadian organisations intent on owning and controlling foreign-flag ships in international trade have moved their management offshore to environments which are tax benevolent and competitive on an international basis.

Conversely, Canadian organisations more intent on remaining Canadian have either limited their shipping activities or abandoned them.

* Foreign shipping organisations, which would otherwise have chosen to locate all or part of their management to Canada, have not done so.

  Alternatively, if a Canadian presence is essential, that presence is restricted to the bare minimum necessary to service the Canadian aspects of the organisation's international shipping operations.

5. THE RECOMMENDATION

The central recommendation of the study is that:

* the Canadian tax rules should be changed to permit the "mind and management" of international shipping ventures to be located anywhere in Canada on a tax exempt basis.

The initiative should include shipowning, ship management, and the commercial operation of chartered ships under leases, bareboat charters and timecharters.

6. SUPPLEMENTARY ACTION

An appropriate change in the taxation regime would be sufficient to commence an expansion of activity, but, in order to "jump start" and take full advantage of the opportunity, there is an identifiable, short-term need for a focus for information, education and marketing. The supplementary action recommended by the study is the creation of:

* A Shipping Centre Development Office to be located in Vancouver, for an initial 18/24 month period following the appropriate tax change.

The first year budget for this Office would be in the region of $ 275,000.

7. NATIONAL APPLICATION

This initiative originates with an agency which has a specific mandate to identify and promote opportunities for western Canada in an Asia/Pacific context. The resulting proposal is, however, totally national in scope and application.

* International shipowning and management is a sectoral activity which is relatively easy to define. Therefore, containment of the tax exemption within the group of intended beneficiaries is relatively simple. It does not require a regional dimension.

The tax exemption, recommended here, would apply to international shipping activities irrespective of the region in Canada where they are managed and controlled. During the course of the study, opportunities were identified for central, eastern and western Canada. They include the retention of existing international shipping activities and enhanced exporter involvement (all regions), the attraction of foreign companies primarily enagaged in Atlantic trading (eastern Canada), and the relocation of foreign companies primarily engaged in Pacific trading (western Canada).

Defining the activity purely by sector, rather than by region, adopts the approach used by the Task Force on Deep-Sea Shipping which reported to the Minister of Transport in 1985. The Task Force, under the chairmanship of Professor Gunnar K Sletmo, recommended a tax exempt status for International Shipping Corporations (ISCs) - in order to stimulate and expand export-enhancing maritime expertise in the Canadian private sector.

8. TAXATION - INTERNATIONAL EQUITY AND EFFECTIVENESS

The thrust of Canadian tax reform, which parallels reforms adopted in the United States and Europe, is to reduce the scope and variety of tax incentives whilst simplifying and cutting tax rates. The intention is to eliminate the disparate tax treatment of various industries in the interests of equity, effectiveness, and the elimination of abuse and the misallocation of resources.

To suggest international shipping activity be accorded "special" tax treatment appears contradictory to the general thrust of these reforms. In this most international of industries, however, equity and effectiveness can only be measured in an international context - and in this context, Canadian taxation is neither effective, nor equitable.

In the context of the international shipping industry Canadian taxation is ineffective. Firstly, because it has virtually eliminated this sector from the Canadian economy, despite its obvious importance to trade. Secondly, because no meaningful tax revenues are being generated.

In the context of the international shipping industry Canadian taxation is not equitable. The only equity which matters in this totally international business is international equity - and that demands a tax exempt or tax-free environment.

The industry does not need tax incentives or tax subsidies in order to flourish. What is required is tax neutrality - i.e. a genuinely tax exempt or tax-free environment.

More succinctly:

* Subjecting unsudsidized international shipping activity to domestic taxation renders it globally uncompetitive and therefore unsustainable. In order to remain competitive, it will remove its mobile assets to more benign jurisdictions, and the activity will diminish or cease to exist in the country which applied the taxes.

In the simplest terms, this is why Canada does not have an international shipping industry.

Unlike shipping operations in the domestic coasting trades, international shipping is not protected from international competition. The carriage of Canadian exports and imports is part of the competitive global ocean transportation scenario - one where ships necessarily move between different international trades in order to optimise utilisation and earnings, and where freight rates are determined solely by supply and demand. Over the long term, freight rates reflect the absence of tax on vessel earnings.

9. THE TAX REVENUE GAIN

The amount of international shipping activity which is currently based in Canada and which would qualify for tax exemption under this proposal is very small indeed. Much of the limited volume of activity which does take place had been making losses prior to the recent upturn in the freight markets. Several will shortly reach financial positions which entail a tax exposure: and, as a result, they are actively considering a relocation offshore to avoid taxation costs.

Taking into account the relative ease of defining international shipping activities, of controlling transfer payments, and of containing/eliminating the leakage of benefits -

* The direct cost in tax revenues of the proposed initiative will be extremely small.

* The increased level of economic activity in the marine, marine services and general sectors will generate additional tax revenue.

* Overall, there will be a net gain in tax revenues.

10. THE INTERNATIONAL SHIPPING ENVIRONMENT

10.1 A UNIQUE INDUSTRY

International shipping is a unique industry. Its special characteristics may be summarized as follows, it is

* a service industry

* requiring very large capital commitments, e.g.

  US$ 32 million for a new Panamax bulk carrier
  US$ 60 million for a new building large tanker
  US$ 200 million for a new building cruise ship

* whose assets are mobile

* which has been forced to shop internationally for each factor input at least cost, and

* operates in a market place which is

  uninhibited
  internationally competitive, and
  extremely volatile

There is no genuinely suitable analogy or parallel which can be drawn in other industries. International air transport is subject to extensive national, bi-lateral and multi-lateral regulation, and the widespread government ownership positions in national carriers. The international banking and re-insurance sectors contain similar competitive and mobility aspects, but the capital and risk factors are very different.

10.2 RESTRUCTURING

Over the last ten years, there have been substantial worldwide changes in the structure and ownership of the international shipping industry. The changes have been hastened by the length and severity of the shipping recession.

Some traditional maritime countries, such as Norway and the U.K., have seen the size of their national fleets cut by over 75% during the period. Concurrently, there has been a substantial increase in the number of ships and the amount of tonnage (cargo capacity) entered under "open" registers - such as Panama, Cyprus, the Bahamas and Vanuatu. Open registers now contain some 40% of the total world fleet of deep-sea ships. The main beneficial users (ultimate owners) of these registers are the U.S.A., Greece, Japan, Hong Kong, Norway and the U.K.

In general, deep-sea ships operating under the national flags of high-cost developed countries have become uncompetitive and unprofitable. Various measures have been attempted in individual OECD countries to arrest the decline, but the results suggest that they have been expensive failures. The only successful national initiative has been the parallel or second register pioneered by the Norwegian International Shipregister (NIS).

The NIS has been a major factor in repatriating Norwegian-owned foreign-flag ships, and preventing the further transfer of Norwegian-owned ships to foreign flags. It has been unsuccessful, however, in attracting any significant number of foreign-owned ships. The NIS permits the use of non-national crew. The other major component in the recent expansion of Norwegian shipping activity is the extensive use of K/S tax shelter partnership schemes. These K/S partnerships, which defer personal taxation at Norway's very high marginal tax rates, have provided most of the risk capital which has funded this growth - some $3 billion over the last two years.

10.3 INTERNATIONAL TAX POLICIES

Tax Subsidy Programmes have frequently been the source of equity and debt funding for the shipping industry in the traditional maritime nations. Most of the programmes have been costly and of limited duration.

The performance of the international shipping industry over the last fifteen years shows quite conclusively that long term stability can be maintained when the shipowner operates in a wholly Tax Neutral Environment. It is evidenced by such things as the growing success of the open registers; the performance of the U.S. controlled foreign-flag fleet prior to and during tax reform; and the on-going growth of the Hong Kong shipping community.

10.4 FACTOR INPUTS

The Open Registers and the NIS are successful because they allow a shipowner to combine the various items which make up his costs by sourcing each one in the global market place. This applies to the cost of all factor inputs: whether it is officer and crew wages and benefits, new and second-hand ships, ship financing, subsidies, investment funds, repairs and drydocking, insurance, tax, administration, or flag.

Access to some of these factors are often restricted by the administration of the country in which the shipowner is based. There are two specific and crucial components which are likely to be subject to national restrictions:

* crew nationality, and

* access to, and accumulation of, tax-free funds for investment and reinvestment in ships.

The following conclusion is difficult to escape:

* If the use of either HIGH COST LABOUR or HIGH COST MONEY is mandatory, shipowners cannot be internationally competitive.

11. CANDIDATES/TARGET GROUPS FOR RELOCATION/EXPANSION

11.1 FOREIGN INTERESTS

Neutralisation of the negative taxation issue is sufficient to attract foreign shipowners and managers where these target groups are already interested in British Columbia, particularly if they are subject to existing or potential disadvantages where they are currently located.

The following groups are the main targets:

* **FOREIGN SHIPOWNERS** with existing and potential freight interests in western Canada - primarily **SCANDINAVIAN, EUROPEAN** and **JAPANESE**. High domestic establishment costs in their current locations provide an additional incentive.

* **HONG KONG SHIPOWNERS** looking for alternatives as 1997 approaches.

* Companies presently classified as U.S. **BENEFICIAL OWNERS**, who are contemplating severing the U.S. linkage in order to retain full control over their foreign-flag shipping operations (one result of tax reform in the U.S.A.).

The initiative has generated considerable enthusiasm in several shipowning companies and individuals who are either engaged predominantly in the Pacific trades, or have a significant Pacific Northwest cargo base/interest. The most positive response has come from the **BULK SHIPPING SECTOR** - dry and liquid bulk shipowner/operators.

11.2 CANADIAN INTERESTS

Elimination of the negative taxation issue will encourage Canadian exporters and importers to expand their involvement in the ocean transportation of their products. **CANADIAN EXPORTERS** are major supporters of the initiative. The strategic control of ocean transportation is especially relevant to Canadian exports, where ocean freight costs are a substantial element in the landed cost of the low value natural resource commodities which dominate the offshore export mix. Exporters recognise that the initiative will enhance their competitive options - to sell on a CIF basis (cost, insurance and freight); to engage in ship chartering activities; and to take ownership positions in suitable ships.

Several of the limited number of **CANADIAN-BASED SHIPOWNERS** and **OPERATORS/CHARTERERS** with interests in foreign-flag ships are presently contemplating moving the "mind and management" of their international operations out of Canada. In some instances, the decision to expatriate has already been made. This includes companies in eastern and central Canada as well as British Columbia. These moves will continue the

tax-induced expatriation of Canadian international shipping operations, which has resulted over the years in a significant loss of expertise and economic benefit by Canada to the United States, Bermuda, and Europe. Prompt adoption of the central recommendation of the study would ensure that these operations remain in Canada.

The two largest Canadian owned companies, which established shipowning and operating subsidiaries offshore during the 1960s and 1970s, have indicated that they are unlikely to repatriate these operations to Canada - even if a fully tax exempt environment were to develop. Over the years, their offshore subsidiaries have reached a position where the majority of employees are no longer Canadian, and where they have substantial joint venture and other foreign commitments. Present venues already provide the tax advantages which are under discussion here. Consequently, repatriation holds only limited attractions.

The rather negative response from existing expatriate Canadian companies suggests that those Canadian companies currently faced with a tax-driven move offshore are unlikely to repatriate once they are established offshore.

Several of the smaller ship operators and owners contacted, who either maintain their "mind and management" offshore, or have severely restricted the extent of their current operations, have indicated that they would either repatriate, or expand, these functions in Canada - if the taxation treatment became internationally competitive.

12. THE WINDOW OF OPPORTUNITY

An appropriate change in the tax treatment of international shipping, will give Vancouver a unique business environment on the American coast of the Pacific Basin, and one which will be competitive with Asian centres - specifically Singapore and Hong Kong.

In order to take advantage of the opportunity, the tax changes recommended in the report must take place promptly.

A variety of upheavals in international shipping have created an extraordinarily fluid situation which will not last long.

* The major recession in the shipping markets is over, but present earnings are inadequate to justify the new building programmes which will be required if shipowners are to remain in business over the long term. Although cost pressures have eased, shipowners are well aware that they must explore every opportunity available on a worldwide basis in order to remain cost competitive.

* The national links between the shipowner, the country of corporate domicile, and the country of ship registration have been overturned.

* The political situation in Hong Kong is focussing corporate and individual thinking in Asia on the range of factors involved in a major relocation, and on the alternative venues available. Current immigration to Vancouver provides the city with a unique opportunity in this context.

* Tax reform in Europe and America is quickly eroding the benevolent business environments which has been available to shipowners through exemptions and subsidies. These changes are driving shipping activity away from some traditional centres to other locations which are internationally competitive.

Concurrent with the international adjustments summarised above, Canada (and British Columbia, in particular) has become much more aware of the importance of trade, logistics and the international business environment to its economy and long term development.

* There is a heightened recognition in Canada of the importance of logistics in meeting global competition. This is increasingly apparent in western Canada. Trade with the Pacific Basin continues to grow in relative importance, and ocean transportation is the predominant factor in the logistical chain.

* Western Canada has become very aware that, in order to develop, it must shift its economy away from the extraction of primary resources into the supply of services to international markets. Shipowning, operating and management is a major international service industry which fits perfectly within the desired development pattern.

13. THE DESIRABLE BUSINESS ENVIRONMENT

The study has determined that a suitable business environment for international shipowning and management would contain the following essential or desirable features.

13.1 GENERAL PRINCIPALS

Laissez faire policies.
A minimum amount of rules, which are not subject to frequent change.
Political stability.

13.2 SHIP REGISTRATION AND CREWING

No restrictions on the flag/registry of owned/operated ships.
No restrictions on manning nationalities.
Acceptance of the respective jurisdictions of the authorities providing ship registration and supervising the crewing agreement.

13.3 COMMUNICATIONS

Competitively priced, reliable and accurate international communications: telephone, fax and telex.

13.4 QUALITY OF LIFE

Pleasant living conditions.
Cultural and ethnic tolerance.
Affordable good quality housing.
Internationally competitive living costs.
A non-corrupt, non-violent environment, with an established work ethic.

13.5 GEOGRAPHY

A centralised location in relation to trading patterns: cargo, cargo interests, ports of call, ship repair and shipbuilding yards.

13.6 MARKETS

Easy access to the market place, i.e. proximity to established shippers, charterers and information.
Proximity to a regional freight (and passenger) market.
The existance of a "maritime community".

13.7 ACCESS TO SERVICES

A world class business centre.
Financial:
- Good access to shipping finance, banks, institutions and financial markets.
- Competent and rapid banking transactions, especially international money transfer.
- Unrestricted foreign exchange transactions.

13.8 MEDIUM AND LONG TERM GROWTH PROSPECTS

A bouyant development outlook.

13.9 LABOUR

Access to an expert labour pool - to fill positions requiring specialist qualifications/experience.
Access to a competent labour pool - for general positions.
Good working attitudes.
A non-militant labour force.

13.10 ESTABLISHMENT COSTS

Internationally competitive office/establishment costs: labour, office space and services.

13.11 IMMIGRATION & WORK PERMITS

Immigration status for:
- the foreign shipowner and dependents,
- key personel and dependents.

Work permits for seconded marine staff.

13.12 THE TAXATION REGIME

A tax-free or tax-exempt corporate environment.
A flexible personal tax regime for the entrepreneur shipowner.

14. TRADE SUPPORT - MARITIME EXPERTISE

With 46% of its GDP trade dependent, the Canadian economy is more reliant upon international trade than many of its main trading partners and competitors. By comparison, the proportion of the U.S. economy which is trade dependent is 14%, for Japan it is 17%, Australia 28%, and the United Kingdom 43%.

The 1985 report of the Task Force on Deep-Sea Shipping took full cognizance of the importance of trade to the Canadian economy:

* Shippers need to "have unimpeded....access to an efficient and competitive transportation system of which international shipping is an integral part", and

* the "presence of a strong basis of shipping expertise within Canada is essential in order that Canada may respond more effectively and forcefully to the complex and changing international shipping environment and protect its exports and imports".

The Task Force went on to recommend that Canada adopt policies to encourage and strengthen its expertise and interests in international shipping. The policy vehicle recommended to achieve the objective was the International Shipping Corporation (ISC). That recommendation was directly aimed at stimulating the onshore ownership and control of international shipping. In turn, the shipowning and control functions would generate additional demand for, and foster the development of, the maritime service sector.

Summarising:

* In order to compete effectively, Canadian importers and exporters must have access to maritime expertise.

* To maintain and develop the essential maritime expertise domestically, Canada needs a competitive international shipping industry.

15. PREVAILING POLICY

Canadian involvement in international deep-sea shipping under the national flag has proved uncompetitive under peace time conditions - and virtually disappeared shortly after the Second World War. It has not revived. The situation has resulted in a number of proposals for supportive government action over the intervening years, and they have usually incorporated a tax preference factor.

As a matter of policy, government has protected Canadian ships which trade between Canadian ports from foreign competition. Successive governments have been unprepared, however, to support Canadian ships in international trade through subsidy or cargo reservation. The policy of non-intervention has been examined and re-affirmed on several occasions since the War, most recently by the Task Force on Deep-Sea Shipping which reported in 1985.

With internationally uncompetitive costs under the domestic flag, some participation of Canadian companies in international shipping has developed through the ownership and control of ships registered offshore and flying foreign flags.

Canadian shipowners are not unique in adopting this route. Many other countries, with uncompetitive costs under their national flags, effectively own and control extensive fleets under foreign flags, e.g. United States, Japan, and countries in Europe and Scandinavia. Reliance on offshore flags has accelerated worldwide in the last five years as the extraordinarily low freight markets produced tremendous pressure on operating costs. Historically, most of the governments involved have been sympathetic, if not explicitly supportive, of the switch from direct ownership under national flag to beneficial ownership under foreign flag.

16. SOME PREVIOUS PROPOSALS

16.1 CANADIAN PACIFIC

In the early 1960s, Canadian Pacific was contemplating an expansion of its shipping activities beyond its traditional liner operations into the international bulk trades. An approach was made to the Canadian government requesting that the new venture's management and control be permitted to operate onshore in Canada - but with the taxation regime

adjusted to internationally competitive levels. An accommodation proved impossible, and Canadian Pacific established its extensive foreign-flag bulk operations in Bermuda and the United Kingdom.

16.2 THE TASK FORCE ON DEEP-SEA SHIPPING

The central task set for the 1984/1985 Task Force on Deep-Sea Shipping was to examine whether government should take action to encourage the expansion of the Canadian deep-sea fleet in the light of changing circumstances. Having recommended that no such action be taken, the Task Force went on to recommend a tax exemption for Canadian-based international shipowning and management activities <u>irrespective of flag</u>.

16.3 THE CANADIAN SECOND REGISTER

Since 1985, several Canadian shipowners principally enagaged in the Great Lakes and St Lawrence have expanded into the international deep-sea trades. This has involved re-assignment of existing ships and the introduction of new vessels. Over half of these ships (perhaps eight units out of some twelve involved) are now registered under foreign-flags and employ foreign officers and crew.

A Canadian Second Register has been proposed recently, in an attempt to address the competitive disadvantage of Canadian registered and Canadian crewed ships in international trade. The prime objective is to prevent further transfers of ships to foreign flag, and to recapture the limited number of ships already lost. The "second" or "parallel" register was pioneered by Norway in 1987. It is a method of achieving international cost competitiveness, whilst maintaining a national affiliation.

The Canadian proposal includes cost savings for the shipowner through tax exemptions: a corporate exemption on international business; and an exemption for crew wages, which continue to be paid at the same pre-exemption net level. It is similar to some arrangements which have been permitted under British, German and Danish flags; but the proposed measures do not permit the flexible manning conditions which now prevail internationally under many national flags and under those second registers which have been successful.

Consequently:

* **the cost of operating a ship registered under the proposed Canadian Second Register would remain internationally uncompetitive - albeit by a reduced margin.**

Transport Canada issued a paper in September 1988 which compares the Second Register proposal with the International Shipping Corporation (ISC) model developed by the Task Force. The ISC model has a much broader appeal. The business environment proposed by the Task Force and supported by this study is internationally competitive, and therefore has the potential for success. In addition, its application is universal and not restricted to a very limited number of existing Canadian firms.

Whilst the Second Register may be considered a worthwhile supplement to the ISC proposal, it is one that should be judged on its own separate merits. Its limited objectives should not detract from the broader sweep of the study.

17. THE CANADIAN COASTING TRADES

Foreign ships and non-duty paid Canadian ships are not generally permitted to trade between Canadian ports without prior application and receipt of a coasting license. A license is only issed after the payment of any import duties and taxes which may be applicable. Foreign-flag ships owned and controlled in Canada are also subject to these restrictions.

As the objective of the proposal is the enhancement of Canadian involvement in international shipping, the proposed tax exemption should not be granted in respect of any earnings generated by voyages in the Canadian coasting trades and the Great Lakes.

18. CANADIAN SHIPS AND SEAFARERS

The recommendation of the study does not contain a "flag dimension". Shipowners and operators based in Canada would be allowed an internationally competitive taxation regime for their international shipping operations irrespective of the flag or registration of the vessels involved.

The arrangement does not preclude the employment of Canadian-flag ships or Canadian seafarers. The use of Canadian ships and seafarers would be at the option of the shipowner or charterer, and subject to free market decisions based upon competitive cost levels and rates of hire.

The quality and amount of maritime management expertise in Canada will grow as a result of the initiative. The expansion of Canadian-based commercial and technical competency will ensure that additional opportunities for Canadian ships and seafarers will be identified and exploited.

19. VANCOUVER'S FAVOURABLE CHARACTERISTICS

Vancouver's business environment compares exceptionally well with the "ideal" location. The city has some very major factors working in its favour, and they include:

* political stability
* good, competitively priced communications
* an exceptional quality of life
* cultural tolerance
* an excellent North American location for Pacific Basin operations
* a workable time zone
* a substantial regional cargo base
* unrestricted foreign exchange transactions
* access to a base of established maritime services
* a competent general labour pool
* competitive establishment costs
* excellent development prospects

With the exception of the taxation issue, Vancouver meets all of the "essential" requirements. In addition, it compares favourably, or is at least competitive, in most other areas.

No location would meet the ideal, and there are naturally a few areas in which Vancouver suffers from minor actual, or perceived, constraints. They are individually addressed below.

20.1 POTENTIAL SHORTAGES OF MARITIME SKILLS

Two areas of concern are products of the present level of development of Vancouver as a regional maritime centre. They are:

* the availability of maritime services
* the supply of specialist labour.

The **MARITIME SERVICES SECTOR** in Vancouver has developed to service local and regional demands. It represents an established core of expertise which has the capability to respond and grow fairly rapidly to meet the additional demand which an international shipowning/management community would make upon it. There are some areas which currently do not exist (ship financing), others which are less developed (marine insurance), and some which are quite well established (shipbroking).

As part of the objective of the initiative is the development of the maritime services sector, the existance of a workable base should be viewed as a very positive attribute. The current limitations need only be temporary, and supply will respond to the increased demand over the medium term.

The availability of **WORKERS WITH SPECIALIST SHIPPING SKILLS** can be an important factor in the choice of a location for shipowning and management actvities. It was a factor in the recent decisions concerning head office locations which have been made by several new cruise lines setting up in the United States. In the cargo sector, Vancouver is regarded as having a reasonable supply of regionally-oriented commercial and operating/cargo personnel. Some skills are potentially in short supply - such as low-speed marine diesel supervisory capability, and some areas of ship management.

The labour market in Vancouver for specialist maritime skills has been fairly balanced over the last few years. There has been a small surplus of operations personnel and a slightly tighter position for marketing staff. In addition, there is a fairly significant number of competent marine staff working in other industries, including a number of recent immigrants.

As in the maritime services sector, there is a basis of specialist maritime labour available in Vancouver on which to build. Foreign shipowners and managers will need to transfer key personnel to Canada as part of the relocation process. Short term deficiencies can be rectified through the issue of work permits and limited immigration for qualifying individuals. The process will be similar to the expansion of marine activity which took place in British Columbia during the 1950s and 1960s. At that time, immediate shortfalls in maritime expertise were covered by offshore recruitment

(mainly from Britain and Scandinanvia). Concurrently, Canadian entrants into the maritime industry received hands-on training, and developed specialist skills over the medium term.

Implementation of the recommendations of the initiative will create a significant demand from the private sector shipowner for specialist maritime personnel and service firms in the medium term. The response of the private sector to the opportunities arising from the sustained demand will expand the supply function. The support of educational and training institutions will be necessary, however, and there are appropriate, interested institutions in Vancouver.

20.2 INTERNATIONAL AIR ACCESS

Vancouver's international air access was considered to be generally adequate by most contacts. Several U.S.-based cruise lines, however, with extensive Canadian experience consider that Vancouver has major drawbacks when compared to U.S. locations. The negative features include limited trans-border flights, and the more difficult access to some locations when compared to the main U.S. hubs.

20.3 BANKING AND THE INTERNATIONAL TRANSFER OF FUNDS

International ship operating is very dependent upon the quick and accurate international movement of large sums of money. The failure of the banking system to transfer funds at short notice can easily result in the costly detention of a ship in a foreign port. Similarly, there have been many instances internationally of ships being withdrawn from charter, especially in a rising market, because hire monies were not received in the designated bank on time.

There was a litany of complaints from organisations with experience in western Canada concerning delays in the international transfer of funds. Complicated routings (via Toronto/New York), limited tracing capability, and a lack of appreciation of the need for speed and accuracy were the main issues raised. The Canadian banking community must become responsive in this area if Vancouver is to achieve international competitiveness.

20.4 LABOUR CLIMATE

The international shipping industry's perception of the labour climate in British Columbia is generally poor. The perception arises partially from press coverage, but also from actual experience of the British Columbia waterfront.

Two specific labour concerns were expressed with respect to locating shipowning/managing activities in Vancouver:

* potential unionisation and militancy of office workers

* possible action by the International Transport Workers' Federation (ITF) against foreign-flag, foreign-crewed ships calling at Vancouver which are owned or controlled by Canadian-based operators.

20.5 THE AGGREGATE TAXATION ENVIRONMENT

Vancouver's favourable attributes as a potential centre for international maritime commerce far out-weigh the negative items detailed above.

The fundamental constraint, which has ensured that Vancouver has not achieved its natural potential as a major international centre for maritime commerce, is the internationally uncompetitive tax treatment of shipping companies which establish their "mind and management" in Canada.

The application and the level of Canadian personal taxation may also deter some foreign shipping entrepreneurs. Personal tax exemptions for Canadian residents are not part of the proposal. The combination of the corporate tax exemption for international shipping with the tax-free payment of dividends to foreign shareholders would encourage the relocation of shipowning and management activity to Canada - even if the shareholders do not personally relocate.

Shipowners who are used to very simple taxation systems (such as Hong Kong) have difficulty with the complexity of the Canadian taxation system. Others have voiced major concerns over the related concept of "negotiating" a settlement with the authorities, and the uncertainty it entails. It is anticipated that these concerns are likely to prove superficial. A serious interest in taking advantage of a genuine Canadian proposal will quickly result in the retention of appropriate advisers, and the reduction or elimination of this unease.

21. OTHER CENTRES

LONDON and **NEW YORK** have been the predominant centres of international maritime commerce for many years. Each is a major continental trading centre, and a market in international freight developed in both locations to service the trade function. London had the benefit of extensive shipowning under national flag, and both the U.K. and the U.S.A. provided business environments conducive to the development of a cosmopolitan shipowning community. **TOKYO**'s maritime activities tended towards a narrower national development pattern, and international shipowners have usually limited their Japanese presence to local marketing representation.

21.1 THE COMPETITION

Over the last thirty years **HONG KONG** has developed into a major centre for shipowning activity. Originally, the commercial emphasis was on long term employment and Hong Kong's growth as an international chartering/freight market has been relatively slow. **SINGAPORE** is the other main Asian centre for international maritime activity, and the business environment has been specifically structured to encourage its growth.

Development of the international maritime sector is a significant feature of various programmes adopted by cities and countries intent on achieving international business status. Usually these programmes have been associated with the creation and promotion of a ships register; examples include Bermuda, the Bahamas, Cyprus, Luxembourg and Singapore. Other shipping centres have developed, or have been maintained, because of tax treatment policies specific to shipping, or general taxation policies which have accommodated shipping activities. Hong Kong, London, New York, Switzerland, Monaco and others can be included in this category.

Shipowners based in Hong Kong are examining the alternatives available to them in the context of 1997. The Hong Kong shipowner community includes both Chinese and non-Chinese operations (European, Japanese, and others). A broadly spread relocation to Asian, European and other locations which offer tax advantages is possible. It is more likely, however, that much of the movement anticipated will be to one or two main venues. At present, Singapore is favoured.

Singapore has constructed a special taxation regime to attract foreign companies to locate regional headquarters on the island. The preference involves concessionary tax rates which reduce the normal corporate rate from 33% to 10%.

The Singapore authorities recognise the economic value of foreign and domestic maritime activities, and international shipping receives preferential taxation treatment and is generally tax exempt. It has been successful in attracting Norwegian and West German shipowning interests to place vessels under Singapore flag, and to base some shipowning and managing activities in the country. An on-going dialogue is taking place between the authorities and certain Hong Kong shipowning interests, and this is aimed at creating a modified taxation framework which would meet their respective interests.

21.2 THE ROLE MODEL

GREENWICH, Connecticut, is an interesting and recent example of the development of an international maritime centre. The existance of a benign taxation regime at the federal and state levels, proximity to major markets, and a pleasant, inexpensive working/living environment were the initiating factors. Some of its original advantages have disappeared, but Greenwich's maritime community continues to grow as international shipping companies and maritime services relocate. Greenwich has passed a certain threshold level and the development process has achieved its own momentum.

Greenwich has a discernible Atlantic trading bias. There is a broad mix of European, Scandinavian, and Greek shipping interests in addition to east coast North American interests (American and Canadian). Asian participation is small.

<u>Greenwich is undoubtedly a good role model for Vancouver</u> - replacing the Atlantic trade/European emphasis with a Pacific trade/Asian orientation.

In the Pacific Basin most maritime activity is regionally or nationally based. At present, Hong Kong and Singapore are the only significant international maritime centres. Nothing comparable exists anywhere on the American side of the Pacific, and Vancouver is the most logical candidate - providing the taxation issue is properly addressed.

PART 2

THE INTERNATIONAL SHIPPING INDUSTRY

A REVIEW

1. SHIP REGISTRATION AND FLAG

1.1 REGISTRATION

The country (port) of REGISTRATION or FLAG denotes the jurisdiction under which the vessel is officially registered and under whose flag the ship will usually sail. Registration fees, annual tonnage dues and other taxes will be payable to the national registration authority. The country of registration will have certain minimum manning and safety standards, and will have ratified at least some of the various international maritime conventions and protocols which exist concerning safety, manning and pollution control. It may also enforce these rules through mandatory inspection programmes undertaken by either nationally controlled surveyors worldwide, or by delegation to selected classification societies.

Historically, the country of registration was usually the country of ownership and the one where the ship was manned and managed, though the practice of foreign crewing dates back to the Greeks and Phoenicians. Today, this link is often tenuous or non-existent. Open Registers (often referred to as flags of convenience - FOCs) denote countries which have established registers which permit non-resident shipowners to place ships on the register and under the jurisdiction of that country. This permits the shipowner an opportunity to avoid some of the direct and/or indirect costs of operating under his own national flags. These savings may be of a fiscal nature or alternatively accrue through the avoidance of restrictive crewing agreements or regulatory requirements.

The conditions of registration may require the vessel to be manned wholly or partially by the nationals of the country involved, though in some instances waivers may be obtainable. Under certain jurisdictions use of national crews results in a discount on the registration fees. Many developing countries have seen a national register solely as a means of obtaining income and raising foreign exchange; whilst others have perceived it as one ingredient in achieving international business centre status on a tax haven basis.

1.2 TRANS-NATIONALITY

Large sections of world cargo shipping have been unprofitable since 1974 due to an intractable excess supply of ships encouraged by surplus shipyard capacity, easily obtained ship financing, and static levels of world maritime trade.

Consistently low revenue has resulted in tremendous pressure on owners to reduce operating costs. Manning and operating ships is a relatively "low tech" exercise which has allowed a substantial transfer of operations to developing, low-cost countries, especially in South East Asia. Those owners based in high-cost countries who were unprotected by marketing niche or cargo reservation programmes have been forced to innovate through economies of scale, "high tech" specialisation (e.g. gas carriers) and reduced manning - all with limited success - or they have had to move "offshore" in order to remain competitive and in business.

The domination of international shipping by merchant fleets which fly the flag of the country in which the ownership resides, has receded to the point where a large portion of the world ownership of cargo ships cannot be easily ascribed to any particular country. A vessel may be registered in Liberia, fly the Liberian flag, and be nominally owned by a Liberian company, however, the company or individual who receives the benefit of ownership of the vessel (i.e. the beneficial owner) is resident elsewhere. The physical mobility of the assets themselves has probably been exceeded by the international ingenuity mobilized by the ship owner, his financier and managers in locating cost reductions or opportunities to retain capital under adverse market conditions.

The trans-national nature of modern shipping can best be illustrated by a rather extreme fictional example. One which also suggests how a veil may be drawn over the identity of the beneficial owner, and the underlying country of beneficial ownership:

> a ship built in Korea financed by an American bank on the Asian Dollar Market, registered in Liberia, nominally owned by a Panamanian corporation with no other assets, legally owned by holders of bearer shares, bareboat chartered to a Bermuda company, managed by a Hong Kong ship management company staffed by Indian superintendents, crewed by British officers and Filipino ratings, insured through London underwriters and entered in a Swedish mutual P & I Club, time chartered to a Japanese operator under a contract fixed in New York, employed to carry Canadian coal to Japanese steel mills.

1.3 DEPENDENT AND SECOND REGISTERS

Certain registers have been designed to give ship owners some fiscal and manning freedom without the complete destruction of the national link e.g. Netherlands - Netherlands Antilles; U.K. - Isle of Man. These are sometimes referred to as dependent or colonial registers, or national "offshore" registers.

In 1987, Norway, faced with a major exodus of ships, achieved a comparable solution by establishing a Norwegian "offshore" register onshore (the Norwegian International Shipregister - NIS). The NIS has proved very successful in containing flagging-out and in repatriating flagged-out Norwegian-owned ships. It has been a significant factor in stimulating the Norwegian shipping industry over the last year.

The NIS experience has started a trend, with most developed maritime nations considering or implementing similar parallel systems. Hard pressed owners in countries without such offshore registers, and where the response from government and seafaring unions has been unsympathetic, have had little option but to continue to move offshore, frequently severing the national link completely, or to abandon the business.

1.4 DUAL REGISTRATION

Several jurisdictions actually permit dual registration, so that a ship can be effectively registered in two countries, though it will fly the flag of only one. This is also known as bareboat registration. The concept was originally designed as a post-1945 method of placing ships under the West German flag when that country had an inadequate supply of capital to invest in shipping assets. Subsequently, it was adopted by other countries for similar reasons - notably the Philippines and Mexico. Dual registry permits the registration of mortgages and other liens against the vessel in its original registry jurisdiction, whilst it is operated under the rules and regulations of the flag jurisdiction.

Use of second registries has developed further as investors and shipowners have realised the advantages of accessing the capital jurisdiction of one country and the operating jurisdiction of another. A major example of the dual registry linkage of two jurisdictions is West Germany and Cyprus - which has combined the access to West German tax shelter partnership capital with the operating flexibility of the Cypriot flag. The Philippines has also become a significant

recipient of dual registry tonnage. This has allowed the country access to shipping assets without the allocation of scarce capital resources, whilst the shipowner is able to place Filipino crew on a Philippines-flag vessel - a national linkage which goes a long way to meet the aspirations of the United Nations Conference on Trade and Development (UNCTAD) and the International Transport Workers Federation (ITF).

1.5 GENERAL

The changes in worldwide ship registration which have taken place recently, and those which are contemplated, are motivated by the need to achieve more cost effective and flexible combinations of capital investment and operating environment - in order to be competitive internationally.

The accompanying table INTERNATIONAL SHIP REGISTERS - BASIC CONDITIONS (Table 1) compares 21 of the open, territorial and parallel registers. The degree of manning flexibility permitted by each register, as shown in the last column, is a major consideration for the shipowner when choosing the flag under which to register a ship. Consequently, it is a significant factor in determining the success of the register in attracting ships.

An indication of the importance and potential variation in total manning costs under various crewing options is demonstrated in Table 2. Table 2(A) compares the manning cost alternatives which are likely to face a North European shipowner in the real world; whilst Table 2(B) compares the theoretical manning costs for various flags, including Canadian, on the assumption that the ship is manned by nationals of the country of flag.

INTERNATIONAL SHIP REGISTERS - BASIC CONDITIONS TABLE 1

Flag /Register	Ship Age Limit (waivers = W)	Dual Reg.	Manning Constraints
Antigua & Barbuda	none	yes	none
Bahamas	max 12 years W	yes	none
Bermuda	none	no	snr officers British (wide
Cayman Islands	none	no	snr officers British
Cyprus	max 17 years (waiver 18/20)	yes	15% Cypriot (waiver)
Denmark	not known	no	senior officers Danish
Gibraltar	none	no	master (c/off) British
Hong Kong	max 10 years W	no	snr officers British (wid
Honduras	max 25 years	yes	90% Honduran (sub avail.)
Isle of Man	none	no	snr officers British (wid
Kerguelen	?	?	25% French
Liberia	max 20 years W	yes	none
Malta	none	no	none
Dutch Antilles	none	no	master Dutch (waiver)
N.I.S.	none	no	master Norwegian (waiver)
Panama	max 20 years W	yes	10% Panama - not enforced
St Vincent	max 40 years	yes	none
Singapore	max 15 years	no	none (incentives)
Sri Lanka	max 20 years	no	50% Sri Lankan
Turks & Caicos	none	no	snr officers British
Vanuatu	max 20 years W	yes	none

Note 1: No information is available concerning following registers Luxembourg, Madeira, Macau, Marshall Islands, and Gambia.
Note 2: British (wide) = U.K., Commonwealth, Eire

Source: adapted from Guide to International Ship Registers (Jly 198 The International Shipping Federation

TABLE 2

OPTIONS AVAILABLE TO A SHIPOWNER
THROUGH SELECTION OF REGISTRY AND CREW

(A) COMPARISON OF ALTERNATIVE MANNING/COSTS SCENARIOS (US$)

OPTION	CREWING MIX		ANNUAL MANNING COST (1)
A	10	N. European Officers	
	15	N. European Ratings	780,000
B	5	N. European Officers	
	5	Filipino Officers	468,000
	15	Filipino Ratings	
C	10	Indian Officers	
	15	Indian Ratings	408,000
D	10	Filipino Officers	
	15	Filipino Ratings	282,000
	(national flag/dual registry)		

Note (1): excludes repatriation costs and victualling - significant differential if N. Europeans used

Note: all of above combinations either eligible for ITF blue card; or (Option D) effectively exempt.

Source: adapted from Lloyds Shipping Economist October 1987 "Which Flag?"

(B) INTERNATIONAL COMPARISON - THEORETICAL

ANNUAL CREWING COST FOR A 60,000 DWT BULK CARRIER - 1987

	C$'000s
JAPAN	2,915
CANADA	1,834
NORWAY	1,830
UNITED KINGDOM	1,325
BRAZIL	1,028
SOUTH KOREA	704
LIBERIA	651

Note: assumes national manning

Source: adapted from Deepsea Vessel Cost Study Transport Canada February 1988

2. THE FUNCTIONS OF SHIP OWNERSHIP AND MANAGEMENT

A shipping company will perform certain departmental functions irrespective of trading area, commodity specialization, flag or office location. An associated figure (TABLE 3) outlines a possible departmental/functional division for a typical traditional European operator - of bulk carriers, or mixed fleets. An operation of this type, with a fleet of about 30 to 40 ships, would employ over 100 office-based staff.

Although the same functions will be performed in many differing types and styles of shipping operations, the emphasis each function receives will vary depending on the marine activities undertaken. For a cruise line, the catering function would be heavily extended and subdivided into hotel services - including entertainment procurement, shore-tour organisation and destination services. Similarly, the structure of the marketing function would change dramatically between a liner company, a tramp market operator and a passenger carrier.

Traditionally all of the ship ownership and management functions would be performed in one location. They can, however, be divided into various "bundles" of functions, and it is the geographic dispersal of these bundles around the world which gives rise to the current opportunity.

2.1 SUB-CONTRACTING AND SPECIALIZATION

There has been a growing tendency for owners to sub-contract the ship management functions. Specialist ship management companies in the U.K., Hong Kong, Singapore and Norway have been particularly successful in offering ship management services. The supply of marine personnel - usually crew and junior officers - has become a specialist area for crewing agencies based in inexpensive maritime locations - such as the Phillipines, Korea, Hong Kong and Indonesia. In a parallel move, many of the cruise lines now operate on a concessionaire basis and sub-contract out the hotel functions (et al), including the supply of sea-going hotel personnel.

Whilst the marketing function will normally require a major presence in the company's prime markets, the management of the marketing function is not geographically constrained in the same manner. A bulk carrier operator with prime markets on the West Coast of North America, Japan, South America and Europe may control its marketing from Scandinavia with branch offices in Seattle and London, owner's brokers in New York,

agents in Europe and South America and joint venture partners in Japan. The marketing control, however, could be located in Holland, Philadelphia, Vancouver or Tokyo instead of Scandinavia.

2.2 MOBILITY AND ASSET DEVELOPMENT

The internationalizing of the functions of beneficial ownership, flag, manning and husbandry has resulted in such a loosening or elimination of the national identity of the effective control of the ship and the shipping company that the organisation has the mobility to locate wholly or partially wherever the perceived benefits are greatest. In effect, the various functions have become international "service commodities" and the shipowner is free to shop internationally in a growing number of market places for each one.

Whilst many of the day-to-day marketing, technical and operational functions can be placed at arms-length, the development function will normally remain within the owners immediate control. This specifically refers to the ordering of new vessels and the sale and purchase of second hand ships.

The absence of the ownership/development functions from the Vancouver scene, and its lack of international status in this connection can be illustrated by the following incident which took place in 1986:

> when a Vancouver court ruling prevented the enforced auction of a modern bulk carrier arrested in the port as a result of creditor action. The court concluded that Vancouver was not a good or recognised location for a judicial ship sale to take place. Consequently, the proceeds from the sale would not reflect the fair market price of the ship. The local marine community responded vociferously and pointed to Vancouver's developed maritime infrastructure as a sign of the city's international maritime status.
>
> This infrastructure, however, does not include shipowners (or their agents) who actively trade in ships as a financial commodity. As long as that judgement remains valid, Vancouver cannot be considered a genuine international maritime centre.

2.3 A VANCOUVER EXPERIENCE

One of the few Vancouver-based offshore shipping companies, which operated in a specialized market sector, owned foreign-flag vessels crewed by European senior officers with ratings and junior officers supplied through a Far Eastern crewing agency. The operations and insurance functions were performed in the U.S.A. Marketing was controlled in Vancouver and worked through European and New York brokers and U.S., Mexican and Japanese sub-offices, and supplemented by marketing representatives and agents in various other locations in Asia, and Central/South America.

Although overall control was based in Vancouver, many of the departmental functions were maintained elsewhere. The organisation had no protected markets, and for its survival it had to be internationally competitive. The geographic dispersal of functions was a product of ownership, history, marketing, fiscal considerations, labour agreements, and cost pressure. Some twelve Vancouver jobs were maintained in spite of the total absence of Canadian business.

TABLE 3

SHIPPING COMPANY - BULK CARRIER OPERATION
POSSIBLE DEPARTMENTAL/FUNCTIONAL DIVISION

1. SHIP MANAGEMENT & HUSBANDRY

1.1 TECHNICAL

Engineering
- Repair and Maintenance/Superintendency
  - Hull
  - Machinery
  - Cargo Equipment and Spaces
  - Accommodation
- Electrical
- Radio & Electronics
  - Navigation Equipment
  - Engine Room control systems
  - Automatic monitoring systems
- Fuel/performance monitoring

Marine Superintendency
- Navigation
- Safety & Firefighting

Cargo handling
Technical procurement
Cost control

1.2 MARINE PERSONNEL

Recruitment
Training
Disciplinary procedures
Payroll
Crew travel

1.3 CATERING

Menu control
Food, beverage and dry stores procurement
Accommodation upkeep

2. COMMERCIAL/ADMINISTRATIVE

2.1 INSURANCE

Selection, negotiation and placement of cover
- Hull and Machinery

Protection & Indemnity
Umbrella and miscellaneous coverage
Claims negotiation and recovery

2.2 ACCOUNTING

2.3 FINANCING

2.4 LEGAL & CORPORATE

3. COMMERCIAL/MANAGEMENT

3.1 OPERATIONS

Instruction of vessels and agents
Post fixture control
Co-ordination
Marine fuel purchasing

3.2 MARKETING

Soliciting and negotiation
charters
contracts

4. COMMERCIAL/DEVELOPMENT

4.1 PLANNING & DEVELOPMENT

Commodity flow forecasts
Project analysis
World trends and freight rate forecasts

4.2 PROJECT ENGINEERING

New building concepts and design
Naval architecture

4.3 SHIP SALE & PURCHASE

Asset values assessment
co-ordination of
new building negotiations
sale and purchase of second hand units

5. GENERAL MANAGEMENT & OWNERSHIP

3. TRENDS IN WORLD SHIPOWNING

The number of ships and the deadweight tonnage (cargo carrying capacity) registered under the traditional European maritime flags has dropped dramatically over the last ten years (see Graph 4 and Table 6). The most spectacular losses which have taken place are as follows:

	1978	1987	
	deadweight tonnage millions		increase/ (decrease)
Norway	46.4	9.7	(79)%
United Kingdom	50.5	11.7	(77)%

The deadweight tonnage registered under other European flags shows a 42% decline over the same period, whilst Japan's fleet has reduced by 16%.

In comparison, and looking at deadweight tonnage only, the two main North America registers seem positively healthy:

U.S.A.	23.9	29.1	22%
Canada	3.6	3.5	(3)%

but the figures for U.S.A. and Canada are somewhat misleading - and this is examined in the relevant sections (sections 7 and 9) under the International Review which follows.

Over the same period the amount of tonnage registered under the largest open register, Liberia, has reduced significantly:

Liberia	157.1	98.0	(38)%

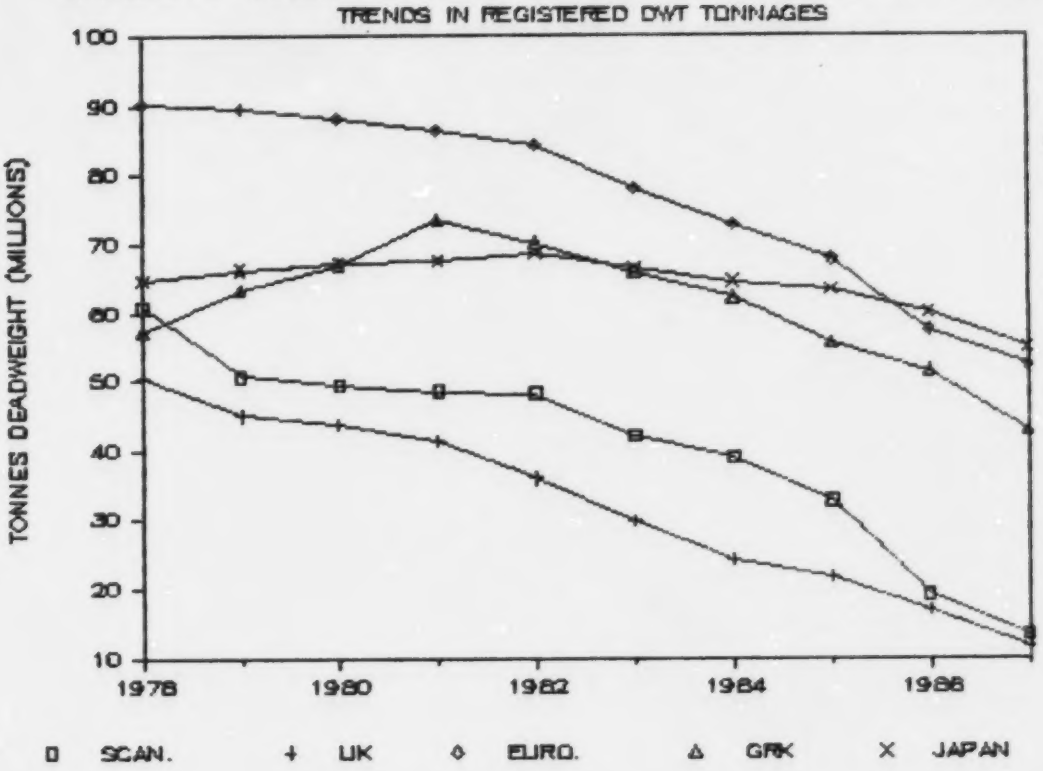
whilst Panama, the other "traditional" open register, and the new open registers, especially Bahamas, Cyprus and Gibraltar, have shown spectacular gains (see Graph 5 and Table 6):

Panama	33.6	70.4	110%
Other Open	7.1	53.5	648%

The picture has become significantly more complicated over the last 18 months with the introduction and expansion of a large number of additional registers - territorial, dependent, and parallel. There are presently over 25 flags under which a ship, benefically owned by a non-national entity, can easily register. Many of these registers now maintain international marketing offices and conduct vigorous "membership campaigns".

MAJOR WESTERN FLAGS – 1978 TO 1987

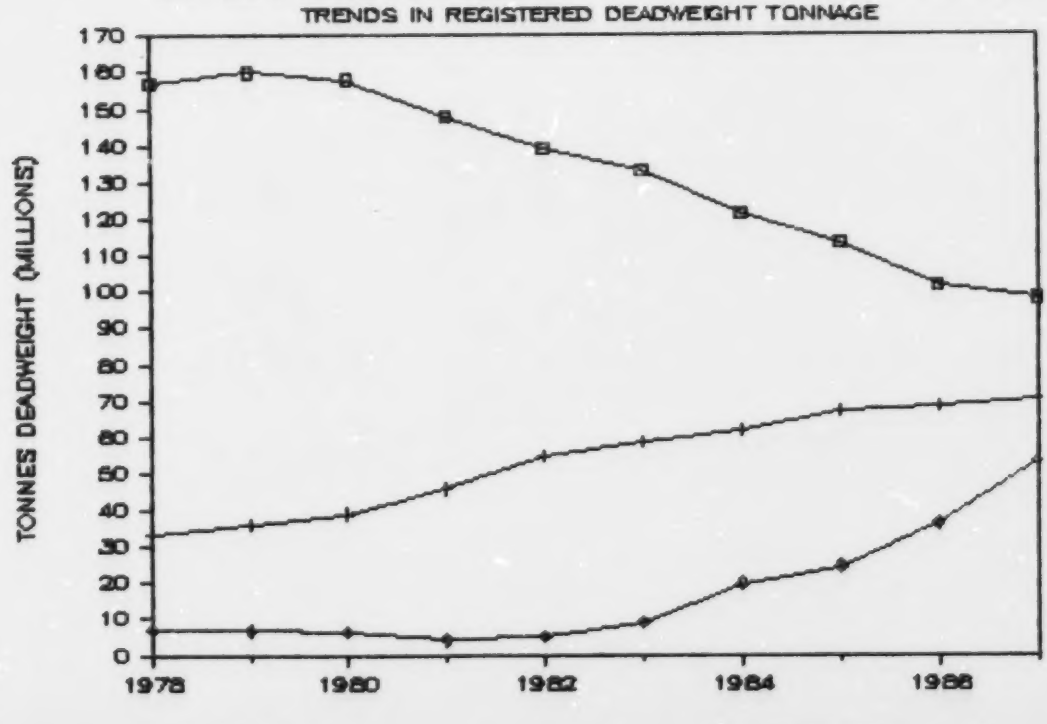
TRENDS IN REGISTERED DWT TONNAGES



Graph 4

OPEN REGISTERS – 1978 TO 1987

TRENDS IN REGISTERED DEADWEIGHT TONNAGE



Graph 5

TABLE 6

MAJOR WESTERN FLAGS: CHANGES IN DEADWEIGHT TONNAGE 1978 - 1987

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
NORWAY	46.389	39.451	38.885	38.502	38.761	33.524	30.604	25.721	14.202	9.657
SWEDEN	10.868	7.375	6.626	6.181	5.794	5.056	5.196	4.231	3.037	2.403
FINLAND	3.541	3.845	3.831	3.795	3.597	3.601	3.209	2.854	1.902	1.401
SCANDINAVIA	60.798	50.671	49.342	48.478	48.152	42.181	39.009	32.806	19.141	13.461
UNITED KINGDOM	50.493	45.080	43.814	41.273	35.990	29.878	24.140	21.795	16.872	11.676
DENMARK	8.939	8.980	8.702	7.978	8.143	7.926	7.973	7.419	6.805	6.961
W GERMANY	15.700	13.745	13.332	12.409	12.355	10.797	9.519	9.241	7.745	5.659
BELGIUM	2.600	2.723	2.732	2.948	3.588	3.691	3.890	3.854	3.916	3.654
NETHERLANDS	7.926	8.404	8.998	8.600	8.430	7.480	6.653	5.949	5.994	5.123
FRANCE	21.101	20.825	20.861	21.112	18.727	16.820	15.093	13.712	9.305	8.407
SPAIN	13.482	13.943	13.522	13.801	13.879	12.788	12.122	10.820	9.286	8.388
PORTUGAL	1.872	1.824	2.129	2.180	2.221	2.161	2.684	2.406	1.747	1.703
ITALY	18.698	19.129	17.951	17.429	17.043	16.475	14.939	14.373	12.407	12.178
EUROPE (8)	90.318	89.573	88.227	86.457	84.386	78.138	72.873	67.774	57.205	52.073
GREECE	57.031	63.310	67.047	73.514	70.232	65.986	62.236	55.356	51.294	42.776
USA	23.938	26.259	27.463	28.582	28.926	29.295	29.140	28.992	28.851	29.111
CANADA	3.595	3.661	3.862	3.862	3.940	4.165	4.210	4.075	3.830	3.503
NORTH AMERICA	27.533	29.920	31.325	32.444	32.866	33.460	33.350	33.067	32.681	32.614
JAPAN	64.797	66.315	67.320	67.497	68.528	66.640	64.624	63.451	59.979	54.669
LIBERIA	157.096	160.038	157.978	147.687	139.250	133.240	121.394	113.552	101.588	97.958
PANAMA	33.610	35.927	39.039	45.738	54.800	58.319	62.069	67.267	68.349	70.436
HONDURAS	0.141	0.227	0.275	0.269	0.323	0.298	0.390	0.516	0.827	0.741
ORIGINAL FOCs	190.847	196.192	197.292	193.694	194.373	191.857	183.853	181.335	170.764	169.135
BAHAMAS	0.106	0.165	0.120	0.243	0.568	1.184	5.682	6.862	10.600	15.696
BERMUDA	3.068	2.926	2.924	0.732	0.711	1.291	1.307	1.461	1.760	3.132
CAYMANS	0.246	0.341	0.373	0.399	0.461	0.483	0.510	0.582	2.121	1.051
CYPRUS	3.728	3.362	2.967	2.677	3.361	5.785	11.801	14.299	18.763	27.323
GIBRALTAR	0.001	0.004	0.004	0.063	0.025	0.377	0.448	1.021	2.998	5.293
VANUATU	0.000	0.000	0.000	0.007	0.003	0.038	0.161	0.226	0.274	0.982
NEW FOCs	7.149	6.798	6.388	4.121	5.129	9.158	19.909	24.451	36.516	53.477
WORLD TOTAL	670.418	681.490	690.855	697.188	701.979	694.512	683.286	673.692	647.639	640.764

Source: Lloyds Statistical Tables

Estimation of the proportion of world shipping currently registered under open flags is complicated by the inclusion in national and summary statistics of ships which do not have ocean-going capabilities; those which have these capabilities but operate predominantly in domestic trades; and the inclusion of ships which are used exclusively in military support or belong to ready reserve fleets. As a consequence, most comparisons are based on the gross numbers entered under each flag. This is the method used in those graphs and tables incorporated into this paper, which are largely based on Lloyds Statistics.

When the vessels which do not participate in ocean-going international trade are excluded, it is estimated that over 40% of the world fleet is now entered in open registers - traditional registers and new ones.

The initiation and expansion of parallel and dependent territorial registers is diverting vessels from both open registers and national registers; when these semi-national registers are included with the open registers, the proportion of the world fleet under open registers approaches 50%.

The decline in deadweight tonnage registered under the main western flags, and the changes in open registry fleets are set out in Graphs 4 and 5, and in Table 6.

3.1 THE BENEFICIAL OWNERSHIP OF OPEN REGISTRY FLEETS

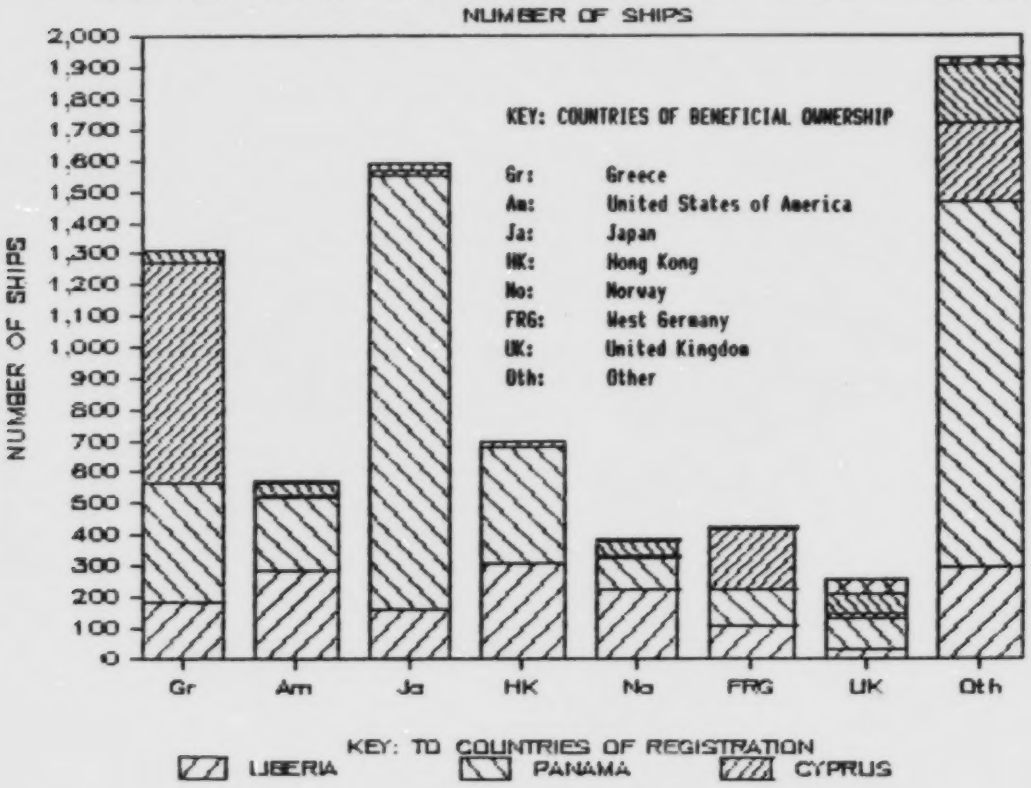
The extensive use of open registers is not confined to OECD or western countries - the P.R.C. is a substantial user, as well as Taiwan, Singapore, Hong Kong and many others.

Obtaining accurate figures on the true beneficial ownership of open register fleets is no easy task. The most up-to-date international analysis was undertaken for UNCTAD and produced in 1987 - these figures were used as the basis for the Graph 7 - Beneficial Ownership of FOC fleets.

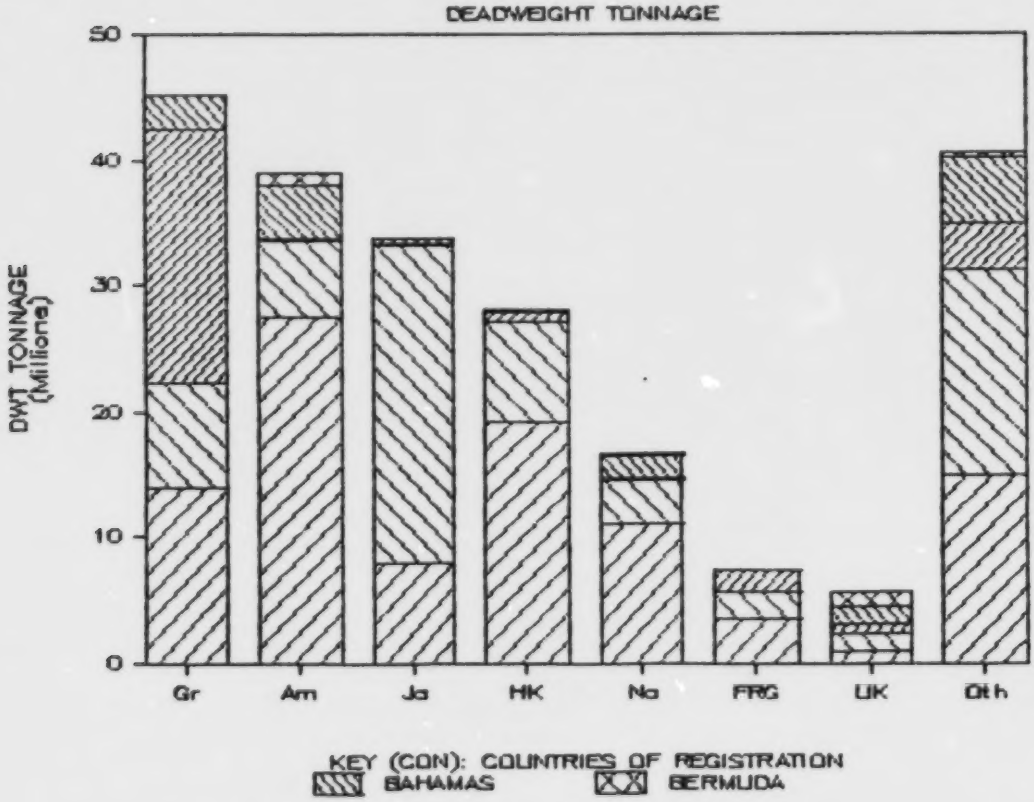
In addition, various national authorities also undertake surveys and estimates of the open registry fleets beneficially owned by residents and nationals. These official and semi-official estimates have been used in the International Review Section of this paper. There are some significant variations between these national figures and UNCTAD's.

Shipowners in Greece, the U.S.A., Japan, Hong Kong, Norway, West Germany and the U.K. are identified as the major users of

BENEFICIAL OWNERSHIP OF FOC FLEETS



Graph 7A



Graph 7B

Source: UNCTAD review of maritime transport 1986
Beneficial ownership of open registry fleets: UNCTAD secretariat 24 Nov 1987 TD/B/C4/309

open registers. These countries accounted for 73% of the vessels and 81% of the deadweight tonnage, respectively, in 1987. There are significant variations in the relationship between the number of ships and associated deadweights accredited to each country. The deadweight to number-of-ships ratio for Greek, American, Norwegian and Hong Kong beneficial owners is high due to the preponderance of large tankers and bulk carriers registered under foreign flags. The ratios for Japan and West Germany are reversed, as smaller bulk carriers and small container/semi-container ships predominate.

Identification of the nationality of the beneficial owners can also be misleading. Several West German shipowners now reside permanently in Cyprus. Many Greek owners are effectively resident of New York, London or Cyprus, though they are still counted as beneficial Greek owners; whilst Monaco, Bermuda and other tax havens play host to shipping entrepreneurs of various nationalities.

3.2 REVERSING THE TREND

The very rapid decline in national merchant fleets has come to be viewed with alarm by some governments and with relative equanimity by others. Where the merchant fleet has been a major source of employment, national product, and foreign exchange earnings, there is natural tendency for greater support levels and innovative solutions to arrest the decline (Norway, Denmark and Greece). National defence is frequently a major argument in favour of support policies (U.K., U.S.A. and other NATO countries); as are concerns about export/import reliance on foreign shipping (France). Linkage with domestic shipbuilding policy (Belgium and Italy), and the continued access to maritime personnel for the port industry (Holland), are additional reasons which have been put forward in Europe for the adoption of support policies. The possibility of a European Community register (tax exempt, crewing flexible) has also been mooted.

The only countries which have formally adopted solutions regarded as long term, rather than interim, are Norway and Denmark. Both countries have introduced second registers which include flexible manning conditions. In both instances, however, tax shelter partnership financing is an additional and fundamental policy instrument designed to maintain the levels of investment in technically advanced modern tonnage. The decline in Norwegian shipping activity has been substantially reversed by these measures.

Informal or tacit acceptance by the authorities of such solutions as dual register arrangements (West Germany), and territorial registers (U.K./Isle of Man), contain inherent problems. In both countries shipowners received some support for these moves from their respective transport ministries. Subsequently, the national finance and revenue authorities have concluded that the schemes conflict with national taxation objectives, and have initiated steps which may inhibit the continued use and expansion of these vehicles.

A similar situation applies in the U.S.A., where for many years the foreign-flag Effective U.S. Controlled fleet (EUSC) was counted as part of the military support fleet, with its existence and expansion duly sanctioned through fiscal measures. Changes in fiscal treatment flowing from tax reform will result in a substantial diminution of this fleet over the next few years.

In Europe, it is the beneficially controlled Greek fleet which is showing the greatest signs of recovery along with the Norwegian one. The Greek authorities have introduced initiatives which have provided some encouragement for Greek flag operations. Most of the present expansion originates, however, with Greek owners who place their ships under open registers.

Sections 5 through 9 of Part 2 of this study reviews the structure of international shipping and current developments in Europe, Hong Kong, North America and other shipping centres.

4. A COMPARISON OF VARIOUS FLAG AND MANAGEMENT SCENARIOS

The International Review which follows outlines the wide range of policies which have been adopted by the governments of maritime nations, over the last ten to fifteen years, when dealing with issues in the area of international shipowning and management.

An in depth comparison of the costs and benefits of these alternative policies would be a most interesting exercise. But the plethora and confusion of policy objectives (shipbuilding, employment, military support, trade security, foreign exchange, balance of payments, etc.) would make an assessment of the actual achievement of objectives virtually impossible. Several conclusions can be drawn, however, from the experiences of others.

4.1 THE DOMESTIC MARKET

The only effective protection which can be afforded to a high-cost domestic fleet is through the prohibition of foreign ships in the domestic cabotage trades. This is a soft policy option for government as operating subsidies should not be required. Over the long term, freight rates will adjust to provide an adequate return to the shipowner. Intervention is limited to prohibition of foreign access, and the granting of exceptions, which is relatively simple to administer and to police.

When the cabotage policy is tied into a domestic shipbuilding policy, shipbuilding can be protected through import duty assessments. The necessary premium over world price which must be paid for the domestically-built ship can be passed on to the customer over the life of the asset through the competitive price mechanism which operates inside the restricted domestic marketplace. Again this is an easy policy option to administer and subsidy intervention at both the construction and operating levels should not be necessary.

For a country with a high cost merchant fleet, domestic freight rates under cabotage will be maintained above international levels and will cause logistical distortions - such as the substitution of other modes of transport and the curtailment of trade flows. The experience of the United States provides good examples of these distortions.

4.2 THE INTERNATIONAL MARKET

4.2.1 CARGO RESERVATION

Support policies in the international shipping markets are much more complex - particularly in the non-liner trades. Cargo reservation is one alternative. This may take the form of reservation of government generated cargoes, such as military and aid shipments - e.g. U.S.A.

Various countries have used cargo reservation and freight direction to support their merchant fleets in international trade. Several developed countries have insisted upon flag reservation for a portion of their bulk import cargoes - the justification is usually the protection of strategically important and vulnerable cargoes and routings e.g. crude oil - as in France.

Cargo reservation has also been a fact of life for many years in trade with some developing countries, particularly in South America. The UNCTAD Liner Code has equitable cargo reservation in the liner trade as its objective. A similar proposal for equitable sharing of the bulk trades has not received the same degree of support.

Cargo reservation invariably limits or removes the competitive market forces which usually determine freight rates. The result is additional freight costs. Higher freight rates increase the landed cost of goods shipped under cargo reservation, rendering importers and exporters less competitive in international markets. Trade will be restricted and some commodities may cease to move entirely.

4.2.2 SUBSIDIES, TAX BREAKS, AND OTHER MEASURES

In the short term, a high cost domestic operator can continue in business if the international market is providing above average returns. In the longer term, the same operator must drive down its cargo unit cost to competitive levels through technical innovation, economies of scale, operating efficiency, or the exploitation of market niche. Where the high cost operator is unable to achieve a satisfactory return, the choices are abandonment or resort to government assistance and intervention measures.

The range of intervention measures which have been used in the past by various governments are extensive. Operating subsidies; construction subsidies; loan guarantees; subsidised

funding - interest rates, moratoria, forgiveness; investment grants; special tax shelters for investor partnerships; capital allowances - depreciation, extra depreciation, free depreciation; tax free re-investment on capital gains and undistributed profits; tax and welfare exemptions and subsidies for seafarers; redundancy funding; fuel subsidies; and many more.

4.2.3 OVERALL

Inspite of all these intervention measures, virtually no traditional maritime country has been able to maintain a secure position for its domestic fleet in the international trades. The severe shipping recession concentrated the changes that have taken place into a relatively short timeframe.

International shipping in general, and international bulk shipping in particular, has the ability to select and combine the prevailing least cost factor inputs. Selection of each factor input is determined by an international price comparison where the price of each factor may be individually subsidised or distorted by the producing domestic jurisdiction. This applies to the costs of all factor inputs: whether it is officer and crew wages and benefits, new building prices, financing costs and subsidies, investment funds, repair and drydocking costs, insurance, tax, administrative costs, or flag.

Some developed maritime countries have attempted to arrest this trend by specializing in high-tech areas of shipping such as gas carriers and self-unloaders. This move has provided only limited breathing space, and has afforded little long term protection. The technology advance spreads rapidly, and is soon adapted for, and combined with, the lowest cost factor inputs to achieve least cost operations.

The Norwegian International Shipregister and the Open registers permit the combination of factor inputs in the most cost effective manner on an international scale. This specifically applies to the two main cost elements which are usually determined by flag nationality, i.e.

* manning costs, and
* the mobilization of tax free, tax exempt, or tax deferred capital.

4.3 WHAT ARE THE SCENARIOS AVAILABLE?

The various scenarios which are currently available, potentially available, or have been considered and/or proposed for Canada's maritime involvement are set out in Table 8. These are numbered Scenarios No 1 through No 7.

Scenario

No 1 represents the existing Canadian **CABOTAGE** position.

No 2 represents the **SUPPORTED** Canadian deep-sea fleet option, considered and rejected by the Task Force on Deep-sea Shipping. A scenario which the Canadian exporters vehemently oppose due to the negative impact of cargo direction policies on trade.

No 3 is similar to No 2, except that only non-Canadian trades are involved, so cargo reservation is not an available intervention policy for **SUPPORT**.

No 4 is the Canadian **SECOND REGISTER** as recently proposed with crewing restricted to Canadians.

No 5 is the International Shipping Corporation (**ISC**) Proposal.

No 6 is the present position which prevails for Canadian companies operating in international shipping. i.e. **OFFSHORE** subsidiaries and the expatriation of "mind and management".

No 7 leaves the whole business to someone else - **FOREIGN**.

Currently, Canada is involved in the shipping business through Cabotage (Scenario No 1) and Offshore Management (Scenario No 6). Cargo reservation and other support policies (Scenarios Nos 2 and 3) were opposed by the Task Force on Deep-sea Shipping - a rejection which represents a continuation of the existing Canadian policy of non-intervention.

Scenario No 4 is the Second Register Proposal and Scenario No 5 is the ISC proposal.

Scenarios No 4 and No 5 do not need to be viewed as mutually exclusive. The corporate tax element of the Second Register is also contained in the ISC proposal, whilst the personal tax element under the Second Register Proposal can be dealt with on its own merits as a specific Canadian-flag support programme.

The ISC proposal in Scenario No 5 effectively recommends that Scenario No 6, the prevailing OFFSHORE option for Canadians, be brought ONSHORE to Canada under offshore terms and conditions.

TABLE 8

COMPARISON OF VARIOUS FLAG AND MANAGEMENT SCENARIOS

SCENARIOS	NO.1 CABOTAGE	NO.2 SUPPORT (A)	NO.3 SUPPORT (B)	NO.4 2ND REGISTER	NO.5 I S C	NO.6 OFFSHORE	NO.7 FOREIGN
FLAG	DOMESTIC	DOMESTIC	DOMESTIC	2ND REGISTER DOMESTIC	OFFSHORE	OFFSHORE	OFFSHORE
BENEFICIAL OWNERSHIP	DOMESTIC	DOMESTIC	DOMESTIC	DOMESTIC	DOMESTIC/ FOREIGN	DOMESTIC	FOREIGN
MANAGEMENT	DOMESTIC	DOMESTIC	DOMESTIC	DOMESTIC	DOMESTIC	OFFSHORE	OFFSHORE
TRADE	DOMESTIC	IMPORT/EXPORT	INTERNATIONAL	INTERNATIONAL	INTERNATIONAL	INTERNATIONAL	INTERNATIONAL
CREWING	NATIONAL	NATIONAL	NATIONAL	NATIONAL	ANY	ANY	)
SUPPORT POLICIES	CABOTAGE	potential CARGO RESERVATION and/or SUBSIDY and/or TAX BREAKS	potential SUBSIDY and/or TAX BREAKS	TAX BREAKS - COMPANY - PERSONAL	TAX EXEMPT - COMPANY	TAX FREE	)
NATIONAL COST	HIGH FREIGHT RATES	potentially HIGH FREIGHT RATES and/or SUBSIDY	potential SUBSIDY	intention NIL	NIL	NIL	) NO NATIONAL INVOLVEMENT
TAX COST	NIL	potential LOSS	potential LOSS	LOSS	SUPERFICIAL LOSS IF EX-DOMESTIC SCENARIO 3 NEUTRAL IF EX-OFFSHORE SCENARIO 6&7	NEUTRAL	)
STATUS	COMPETITIVE (IN CLOSED MARKET)	generally UNCOMPETITIVE without support	generally UNCOMPETITIVE without support	generally UNCOMPETITIVE without extra support	COMPETITIVE	COMPETITIVE	COMPETITIVE

5. INTERNATIONAL REVIEW - EUROPE

Over the five year period 1982 to 1987 the amount of deadweight tonnage under European control dropped from 266.5 million tonnes to 180.8 million tonnes. Over the same period, the capacity beneficially owned under offshore flags by Europeans increased in importance from 12.6% to 35.2% of the European controlled fleet. These changes are depicted and analysed further in Graph 9 and Table 10.

5.1 THE UNITED KINGDOM

5.1.1 BACKGROUND

As a maritime trading nation with extensive colonial interests, the U.K. maintained a leading position in the shipping industry throughout the 18th and 19th centuries, and this continued until 1975. The sheer volume of commodity, financial, insurance and freight trading which took place in London created a unique environment where shipowning and maritime service functions flourished.

Between 1975 and 1987 the U.K. owned fleet (under all flags) dropped from 8.9% of the world total to 2.7% - according to General Council of British Shipping (GCBS) figures. The greatest decline took place in the deep-sea fleet, where the number of ships under the mainland U.K. flag dropped from some 950 vessels totalling over 50 million dwt in 1978 to under 100 vessels totalling under 10 million dwt in 1987.

The precipitous decline can be attributed to a combination of factors.

* The U.K.'s pattern of trade changed significantly as the European Economic Community became the focus replacing the British Commonwealth.

* Profitability was eroded during the period by:

  - Excess capacity in most sectors and the consequent abysmal freight rates.

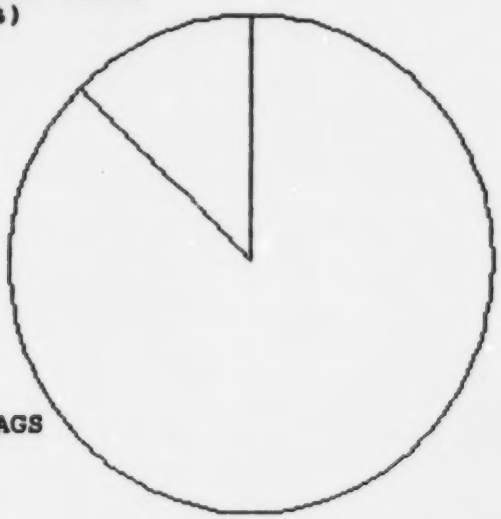
  - Rapidly escalating operating costs under the U.K. flag, especially in crew wages and benefits. This was partially due to the elimination of the traditional Asian crew component enjoyed by many companies.

  - The volatility of the Pound Sterling. For much of the period the Pound was significantly overvalued (mainly

EUROPEAN FLEETS – FLAG COMPOSITION

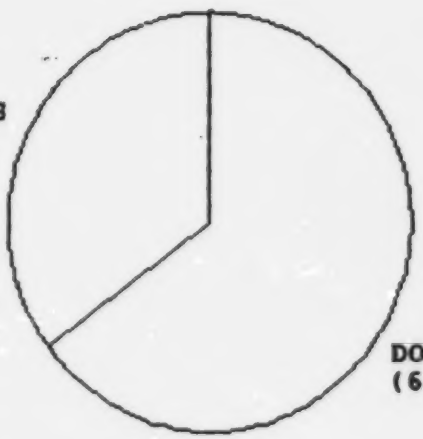
REGISTRATION – DEADWEIGHT BASIS

Graph 9



1982

266.5 MILLION TONNES DWT



1987

180.8 MILLION TONNES DWT

TABLE 10

EUROPEAN FLEETS
FLAG COMPOSITION AND CHANGES BETWEEN 1982 AND 1987
DEADWEIGHT TONNAGE (MILLIONS)

	1982			1987		
	domestic	offshore	total	domestic & parallel	offshore	total
UK	36.0	4.0	40.0	11.7	7.8	19.5
Belgium	3.6	-	3.6	3.7	0.2	3.9
Denmark	8.1	-	8.1	7.0	0.4	7.4
France	18.7	-	18.7	8.4	-	8.4
Greece	70.2	23.0	93.2	42.8	28.0	70.8
Italy	17.0	-	17.0	12.2	-	12.2
Netherlands	8.4	0.2	8.6	5.1	1.2	6.3
Spain	13.9	-	13.9	8.4	-	8.4
West Germany	12.4	-	12.4	5.7	6.4	12.1
Norway	38.7	6.0	44.7	9.7	14.7	24.4
Sweden	5.8	0.5	6.3	2.4	5.0	7.4
	232.8	33.7	266.5	117.1	63.7	180.8

because of North Sea oil), depressing the Sterling value of US$ revenues and escalating Sterling-based costs.

- The withdrawal of several tax advantages.

* Technical change, particularly the growth in containerization, had a major effect in reducing the number of vessels and the associated deadweight allocated to the main liner trades.

* A further factor relates to the ownership structure which had come to predominate in the U.K. shipping industry. Many of the major British shipping companies were either taken over by non-marine parent companies or expanded into non-marine sectors during the 1960s and 1970s. This was largely a result of the extensive tax credits and allowances granted to capital investment in ships - which could also be used to shelter other earnings when consolidated under group relief provisions.

  When the freight markets collapsed, the publically quoted groups were not able to regard the consistently poor performances in their shipping divisions, and the severe erosion of asset values, with the same obstinate optimism which characterised the shipowning entrepreneurs who controlled large portions of the fleets owned in other traditional maritime countries.

5.1.2 BRITISH REGISTERS

Although some flagging-out of ships to both dependent and unconnected foreign flags has taken place, the favoured route adopted by British owners was to sell the vessels to offshore interests, sometimes against a charter back. Union militancy effectively prevented the U.K. owner from easily replacing high cost British crew whilst maintaining titled interest. Subsequently, the continued depression in the shipping markets made both renewal of the charter, when due, or replacement by a new building under the U.K. flag, or any other, by the British owner unappealing.

Under the British register regime it has been possible to register a British owned ship at a recognised port of registry in a British dependent territory. This could be done either directly or through a subsidiary located in the territory. Adaptation of the corporate structure allowed a U.K. owner to take advantage of crewing and taxation elements and inter-relationships between the respective business

environments. The dependent territorial registers fall into three sectors: the inshore variety - Isle of Man and the Channel Islands; the effective convenience flags - Bermuda, Cayman Islands, Gibraltar, Montserrat and St Helena; Hong Kong - which is in a separate class, is not regarded as an FOC, and is expected to develop into a completely independent register over the next few years.

The Isle of Man register has become the U.K.'s second register, it is a half-way house between the mainland register and an offshore flag. The Isle of Man fleet currently stands at about 90 ships of some 4 million dwt. The main benefit to the U.K. owner has been flexibility in crewing. The procedure adopted has been to layoff the crew on the U.K. registered ship, then re-employ some of them (usually the senior officers) through a manning agency located in the Isle of Man, on a self-employed basis. The crew become responsible for their own income tax payments and contributions to social welfare programmes - and are in a position to adjust their exposure within the U.K. residency rules to avoid income tax. This net position is recognised in the wages paid - an effective transfer of benefit from the U.K. fiscal authorities to the owner.

The corporate taxation element depends upon whether the ship is owned through an Isle of Man subsidiary or merely registered there, and the advantages and/or disadvantages of the relative offshore and onshore systems apply.

The Isle of Man option has been encouraged by both the GCBS (the British shipowners' representative body) and the U.K. Department of Transport as an acceptable method of maintaining a nationally linked merchant marine. The Department of Inland Revenue, however, has recently challenged the system and will assess the companies involved to employees' (PAYE) income tax and social security contributions. This is now subject to litigation.

There are wide discrepancies between the various British territorial registries with respect to the adoption of IMO and other conventions on safety, pollution and manning conditions. This also applies to their respective standards and capabilities of inspection and enforcement. A detailed review is being conducted by the U.K. Department of Transport. This is intended to establish a more even system which may also restrict the types and sizes of ship permitted under each register.

5.1.3 THE TAXATION SYSTEM

Direct subsidization of the the U.K. merchant marine has not occurred, excepting a brief flirtation with investment grants prior to 1971. The financing of new building contracts for ships ordered by U.K. owners from domestic yards has been restricted to the levels in the OECD guidelines, though direct shipyard ownership and subsidies have been used to secure orders against foreign competition. Two small subsidies were introduced in 1988 to offset repatriation and training costs. The motivation was defence oriented, and the effect wil be minimal as the total programme cost is estimated at 8.5 million pounds only.

Prior to 1984, the U.K. permitted 100% first year allowances and free depreciation. Although the tax rate was 52% at that time, the system provided significant benefits to companies which were fully subject to corporation tax. These fiscal benefits were withdrawn (effective 1986) by the 1984 Finance Act, when the capital allowance was restricted to 25% on a reducing balance basis. Although the tax rate was reduced progressively to 35%, the effect was to place the U.K. well down the league of European tax support for shipping. (see: Maritime Policy and Management, 1984 VII No.3 - "Ship Finance and Fiscal Policy" for the theoretical model and ranking.)

Prior to the collapse in the shipping market, and the appreciation of Sterling, the U.K. was a favoured location for foreign companies to locate offshore shipowning and ship management subsidiaries, often with U.K. flag tonnage. The fact that much of the disposal of British maritime assets took place prior to the main fiscal changes suggests that the motivating factors behind the original decline were the harsh market conditions coupled with inflexible and increasingly costly national crewing considerations, rather than the tax environment.

5.1.4 THE TREATMENT OF OFFSHORE EARNINGS

Companies incorporated and resident in the U.K. are taxed on foreign earnings of offshore subsidiaries when dividends are remitted. Under the 1988 Finance Act, U.K. owned companies will ultimately not be able to maintain offshore status without Treasury consent.

For individuals, the U.K. has a complex system of rules which takes into account factors described under residency, normal residency and domicile. As a consequence, it is possible for a

non-domiciled individual (effectively someone who is not a U.K. national by birth or choice) to reside in the U.K. and adjust his circumstances to ensure that he is only subject to taxation on his U.K. derived earnings and cash remittances from abroad. Individual foreign shipowners have been able to take advantage of the benign fiscal regime to locate the managing agency companies of offshore owned foreign-flag ships in the U.K., and to effectively reside in the country without being subject to personal income tax on offshore income. The main group taking advantage of this have been the London Greeks plus some Scandinavians.

The Inland Revenue considers the above treatment to be inequitable, and restrictions have been considered regularly since 1975. A Consultative Document was issued by Inland Revenue in 1988 which proposes major changes in the rules, and the adoption of a concept of "fiscal attachment" to the U.K. after seven years residency. Tax would then be imputed on total overseas earnings. If adopted, the foreign shipowners currently based in London can be expected to promptly vacate to an alternative and less hostile environment. The owner would be able to maintain a corporate presence in the U.K., staffed by salaried personnel, which could continue the existing activities. The concern is that these "hands-on" shipping entrepreneurs would not be prepared to separate themselves from these functions - and eventually these functions would also vacate the U.K. This potential change has generated significant opposition in the various maritime service sectors in London, notably the Baltic Exchange and Lloyds.

5.1.5 THE MARITIME SERVICES SECTOR

A study conducted for the British Maritime Charitable Foundation, "The Merchant Fleet and Britain's Economy", in 1988 estimated the extent of employment created in the United Kingdom by the U.K. based maritime industry (British and foreign owned and flagged) as follows:

seafarers	34,000 jobs
shipping - shore based	16,000
merchant shipbuilding and repair	12,000
marine technology	3,000
marine equipment	25,000
the city and commercial services	15,000
Total	105,000 jobs

These were the jobs considered at risk if effective steps were not taken to maintain a British merchant fleet and the foreign onshore presence.

5.2 BELGIUM

5.2.1 BACKGROUND

The Belgian flag merchant fleet numbers approximately 100 vessels totalling about 3.7 million dwt. Until 1986, it had proven to be one of the more stable fleets in Europe, though the numbers of ships had reduced and some seafaring jobs had disappeared. In addition, there are some 30 vessels owned by Belgian interests and operated under offshore flags. Crew costs are high and shipowners have been requesting various measures to provide relief over the last few years, including the ability to use foreign crew at origin country wage scales.

A major factor promoting the relative stability of the Belgian-flag merchant marine has been a shipbuilding support scheme which has offered generous terms to domestic owners. Belgian shipyards are generally uncompetitive, even after EEC subvention payments, and have become reliant on domestic orders placed under the support programme. The scheme provides over 70% of the capital cost at an interest rate of between 2% and 5% repayable over 15 years. In return, the vessel must be kept under Belgium flag for a period in excess of 15 years. The scheme has been successful in keeping the largest yard - Boelwerf - well occupied, and in stopping ships from flagging offshore.

5.2.2 SECOND REGISTER

The Belgian government, the shipowners and the maritime unions agreed in mid-1987 that no more Belgian ships would be flagged-out pending the creation of a Luxembourg Register which was scheduled for April 1988. In the meantime a fund equivalent to US$ 20 million was established by the government as an intervention programme to offset high labour costs - pending the availability of the Luxembourg Register.

In the event, the Luxembourg Register has been delayed due to lack of agreement between the parties, including the maritime unions and the ITF, on the extent of the tax exemptions, and the numbers and nationalities of the allowed crew. It was intended that the new register would be modelled upon the NIS and open to foreign owners.

5.3 DENMARK

5.3.1 BACKGROUND

Denmark has maintained a substantial merchant fleet under its own flag. Danish ships are heavily involved in the cross trades, which is the source of 95% of the fleet's revenue. The industry is the country's third largest foreign exchange earner, after agriculture and manufacturing. It employs some 11,000 Danish seafarers.

The size of the Danish-flag fleet dropped quite sharply in the year to January 1988. The foreign-flag Danish owned fleet recorded a comparable increase, however, as vessels were flagged out and newbuilding deliveries were registered elsewhere.

	Danish-flag		foreign flag	
	no.	m.dwt	no.	m.dwt
January 1987	564	7.0	107	1.2
January 1988	506	6.4	170	2.5
	(58)	(0.6)	63	1.3

5.3.2 TAXATION POLICY

Danish shipping companies are permitted to set aside 25% of taxable income for new shipping investments. Danish individual investors have been allowed to invest in shipowning partnership schemes which grant full tax deferral on personal income rated at very high marginal rates. These generous taxation rules were changed in 1984, but this created a newbuilding crisis in the shipyards - prompting reintroduction of most of the previously terminated features. Less radical restrictions were introduced in late 1987; these appear to have contained, rather than choked off, new partnership tax deferral investments.

Danish seafarers have received special tax treatment for some years.

Denmark operates a domestic shipbuilding credit scheme for ships ordered in Danish or other EEC yards. Standard OECD terms are extended to 12 years with a two year moratorium on repayments. In addition, there is a special low interest rate for loans denominated in Danish kroner. There is also a government loan guarantee scheme for small shortsea vessels.

The government is the major supporter of a "ship of the future" programme designed to retain Danish competitiveness through reductions in crew numbers (to six on middle sea ships, and ten on deepsea vessels).

The result of these schemes is that the Danish fleet is relatively modern and technically efficient. A large portion of the fleet is owned through the partnership schemes and leased to major operators, such as A P Moeller.

5.3.3 THE DANISH INTERNATIONAL REGISTER (DIS)

In spite of these measures, there has been an accelerating loss of ships to offshore flags. This continuous drain prompted the introduction of a new Danish International Register which commenced operation in 1988. The register is open only to Danish owners. Coastal ships and ferries are excluded. The main provision is crewing flexibility, only the Master has to be a Danish national. Recent tax exemptions, however, are so generous that the Danish seafarer is apparently competitive with third world crew.

By August some 100 ships of 3.3 million dwt had transferred to the DIS, albeit that this was mostly transfers from Danish flag rather than repatriated foreign-flag ships.

5.4 FRANCE

5.4.1 BACKGROUND

The French-flag deep-sea merchant fleet declined from around 500 ships in 1977 to under 300 ships of about 8.5 million dwt ten years later. French shipping companies are prohibited from flagging-out their ships, though French controlled overseas subsidiaries are believed to own a further 130 ships. A further 35 vessels are now understood to be registered in the French Second Register - the Kerguelen Islands.

French crews are among the most expensive in Europe, and the cost differential against open register crews approaches US$ 2 million per ship annually. Protection of the French flag fleet has been maintained through coastal cabotage, reservation of portions of crude oil and dry bulk import cargoes, and "cargo direction" of trade with French overseas territories. In addition, there have been some investment grants and subsidies.

In 1986, a new plan was introduced aimed at completely restructuring the industry. There were some 23 measures within the plan designed to provide capital assistance, limited transfer of certain ship types to Kerguelen registry, reduced levels of general-purpose manning, state aid for social security payments, plus the relaxation of various costly regulations. Some US$ 40 million in aid was made available to eight large French companies, and as many as sixteen smaller ones, in return for guarantees of ship and job retention, and assurances that corporate headquarters would remain in France. The new French government has discontinued the restructuring package and has ordered an examination/ re-evaluation of the programme.

5.4.2 THE KERGUELEN ISLANDS REGISTER

Originally announced in June 1986 as part of the restructuring package, this register is located in the French Antarctic Territory. Registry is only permitted for dry bulk carriers and oil products tankers; crude oil carriers may not be entered. French labour legislation does not apply. The proportion of French crew members may not fall below 25% and at least four French officers must be retained. All transfers must be approved by the Secretary of State Marine.

The register is bitterly opposed by the French maritime unions, and has received only limited support from owners.

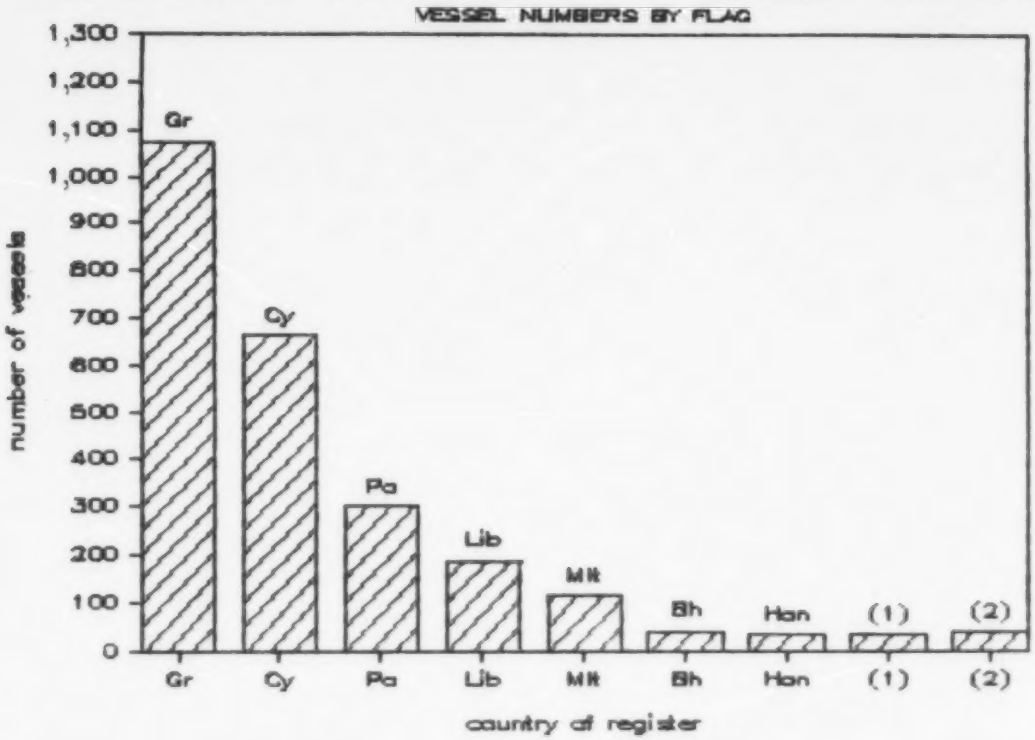
5.5 GREECE

5.5.1 BACKGROUND

The Greek owned and controlled fleet amounts to some 85 million dwt when overseas resident Greeks are included. This makes it the largest in the world, exceeding that of Japan.

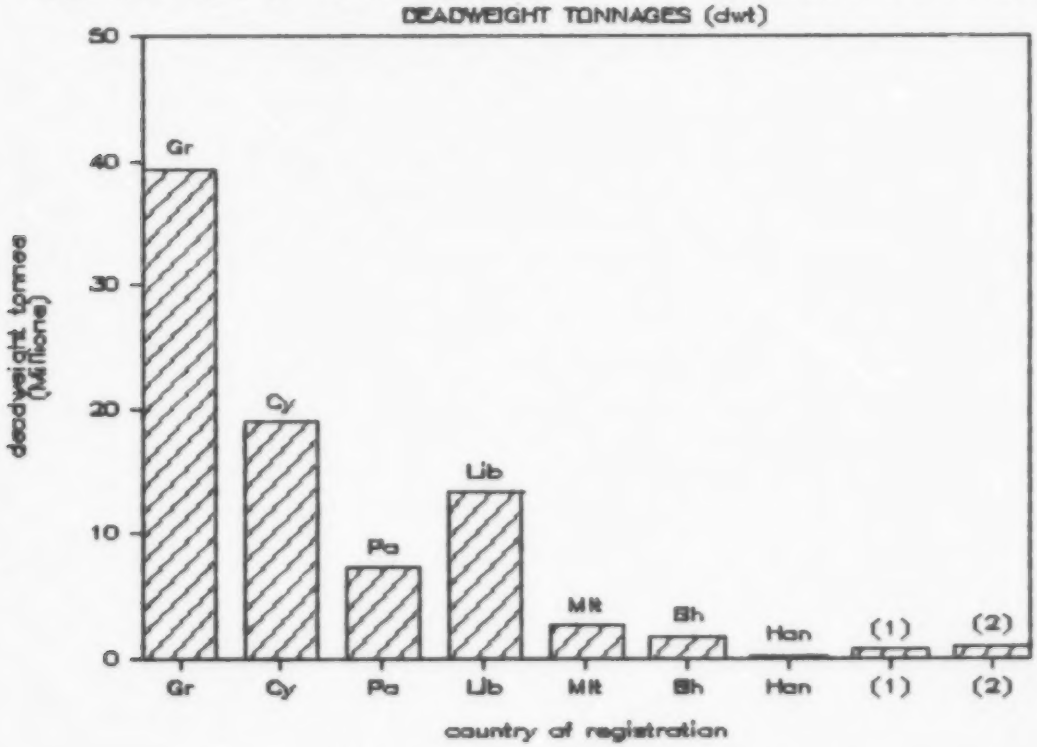
Greek owners have always been major users of offshore flags, the fleet under flags other than Greek was over 50% in 1960/1975; 25% in 1980/1982; and the proportion is some 40% at present. The Cypriot and Maltese flags have become important, supplementing the more traditional registers of Panama and Liberia. See the accompanying figures - Graph 11 and Table 12 for the overall flag distribution as at mid-1988. Major overseas Greek shipping communities are based in New York, London, Cyprus, Monaco and elsewhere - primarily for tax and marketing reasons.

BENEFICIAL OWNERSHIP – GREEK NATIONALS



Graph 11A

BENEFICIAL OWNERSHIP – GREEK NATIONALS



Graph 11B

Gr: Greece
Cy: Cyprus
Pa : Panama
Lib: Liberia
Mlt: Malta
Bh : Bahamas
Hon: Honduras
(1): Other (10/20 ships)
(2): Other (under 10 ships)

Source: Naftika Chronika 5 January 1988

TABLE 12

THE GREEK CONTROLLED FLEET
BY COUNTRY OF REGISTRATION

includes fleets controlled by non-resident Greek nationals

FLAG/REGISTER	VESSELS	DWT	GRT
Bahamas	41	1,742,943	1,020,264
Bangladesh	2	6,032	3,184
Bermuda	1	9,332	6,298
Cayman Is	1	3,300	1,905
Cyprus	664	18,924,767	10,902,377
Egypt	6	165,039	104,057
France	2	170,938	82,446
Gibraltar	10	236,718	147,998
Greece	1,076	39,456,421	21,695,057
Honduras	34	188,276	131,648
Kuwait	1	76,474	39,532
Lebanon	13	272,275	164,165
Liberia	187	13,260,916	6,776,546
Malta	114	2,622,030	1,553,710
New Zealand	3	83,296	52,309
Panama	300	7,226,866	4,211,060
Philippines	5	177,476	102,635
St Vincent	3	3,568	4,049
Saudi Arabia	10	124,989	80,260
Singapore	3	41,473	34,703
Sri Lanka	5	84,896	49,940
U.K.	5	152,851	94,023
Vanuatu	1	16,560	10,852
TOTALS	2,487	85,047,436	47,269,018

Source: Naftika Chronika 5 January 1988

Greece has used various policies to encourage repatriation of ships to the Greek flag, and with varying degrees of success. During the severe shipping recession, the numbers of Greek ships owned under Greek flag virtually halved from around 4,000 units in 1981 to around 2,050 ships of 43 million dwt by 1987. This decline was viewed with some alarm by the authorities. Shipping is major source of foreign exchange earnings for Greece, as high as US$ 1.8 billion in 1981 and currently around US$ 1.2 billion.

Coastal cabotage is strictly enforced. Manning restrictions apply, though a Greek-flag vessel may employ up to 40% foreign nationals.

5.5.2 TAXATION

Ships built and registered in Greece are exempt from basic tax for a six year period. In addition, there is effectively no corporation tax or capital gains tax applied to ship owning and operating. A company which is engaged solely in the ownership, trading and management of Greek merchant vessels may qualify as a Law 959 company and is exempt from all taxes, duties and other charges.

Although the regime appears extraordinarily favourable, many Greek owners prefer to operate under foreign flag. This is partially due to avoidance of Greek manning restrictions, Greek maritime unions, and associated costs; partially due to concerns regarding non-shipping assets; and also the ability of the shipping entrepreneur to operate in an effectively personal tax free environment by locating himself elsewhere.

5.6 ITALY

Over the ten year period to 1987 the Italian flag fleet reduced by about one third to 12.2 million tonnes dwt, however, the numbers of ships fell by less than 10% to 1,570 units. These changes reflect expansion of the coastal and short-sea Italian-flag fleet coupled with an erosion of ownership in the larger sizes. Italy reserves its coastal trade for domestic vessels and has a reservation scheme for some bulk import cargoes. Italian owners are forbidden by law from flagging-out and from the direct ownership of ships under foreign-flag. The acquisition and disposal of tonnage is subject to government intervention, and Italian owners are effectively prevented from ordering vessels from foreign shipyards.

As a consequence of the above policies, Italian owners are largely reliant on direct state funding and subsidies for expansion. Funds have not been forthcoming on a major scale until recently and, as a consequence, the age profile of the fleet has increased and its technical performance declined.

Most of the Italian liner companies are owned by the state, whilst bulk shipping activities are broadly distributed in private hands. Government support measures aimed at aiding both the shipping companies and the shipbuilding sector were introduced covering the period 1986/1995. These measures allocated some US$ 600 million to the state-owned Finmare Group for a major modernisation programme, and a further US$ 175 million in direct subsidies, ship purchase grants, etc to the private ownership sector.

Although the funds set aside to assist the industry are large, the private shipowners are requesting further aid and/or the easing of operating restrictions. Freedom to make independent commercial decisions on assets, including a build- foreign option, and freedom to employ non-nationals or subsidized employment of Italian crew are the main requests. Freedom to flag-out, or demands for a second register are not apparently contemplated.

5.7 THE NETHERLANDS

5.7.1 BACKGROUND

The Dutch flag merchant fleet has shown relative stability over the last ten years. The short-sea sector is extremely important to the economy, and the number of ships has been maintained in this sector at nearly 400 units, whilst its cargo capacity has virtually doubled. The deep-sea fleet under the mainland flag has declined by about one third numerically to 150 vessels, but this has been partially offset by expansion of the fleet registered in the dependent registry of Netherlands Antilles and Aruba. In addition to the 5 million tonnes dwt registered under Dutch flags, a further 90 ships of 1.2 million dwt are estimated to be under unconnected foreign-flags - mainly Liberia, Cyprus and the Bahamas. The Dutch fleet is modern with only one third over 10 years old.

A Dutch owner has been unable to terminate the employment of his Dutch crew if a ship was flagged-out and the positions filled by foreign nationals, and this has tended to limit such action. Restrictions on the employment of Asian ratings on

Dutch ships were lifted in 1987 and a saverence payment scheme was funded by government. The Dutch merchant marine continues to employ some 10,000 Dutch officers and ratings.

5.7.2 SUPPORT SCHEMES

One of the main policy reasons given by government for its support of the Dutch-flag merchant marine, is to ensure that Holland's position as the Port State of Europe is maintained and that the associated maritime infrastructure continues to be properly manned.

The support scheme is complex. There is a restricted 20% subsidy on the purchase of newbuildings and second hand ships under 5 years old which involved tax subsidies and cash installments. Capital gains on ship sales may be held tax free pending re-investment. Additional incentives have been available from time-to-time. Tax relief for seafarers and a reduction in social welfare contributions has been proposed by the Transport Ministry, though this may not receive endorsement by the Ministry of Finance.

Government support over the last ten years has been generally successful in achieving its declared objectives: a soundly structured, modern and stable fleet; employed shipyards; reasonable employment levels for Dutch seafarers; an adequate recruitment pool of skilled mariners for maritime infrastructure needs. Only profitability has been lacking! The government has re-affirmed its support with a new maritime plan which also includes "high-end" specialization, and a "ship of the future" project.

5.7.3 SECOND REGISTER

The Netherlands Antilles has proven to be an adequate territorial/dependent register in most cases, although there has been some discussion of an international register and also some support for the concept of an EEC flag.

5.8 SPAIN

5.8.1 BACKGROUND

The Spanish-flag fleet was maintained at some 2,700 ships totalling over 13.5 million dwt until 1982/1983. This was largely due to substantial support schemes which created a major ordering boom during the late 1970s. The size of the fleet has subsequently dropped by some 400 units to less than

8 million dwt. Reflecting the ordering boom, the fleet is a modern one. Foreign exchange restrictions, duties and other barriers have ensured that the fleet was built domestically. Overseas investment restrictions have prevented any significant foreign-flag ownership.

Cabotage is enforced, and the imports of crude oil, coal and grains are largely restricted to Spanish flag vessels.

Spanish vessels may only be crewed by Spanish nationals.

5.8.2 SUPPORT MEASURES

The support measures provided to the industry during the late 1970s were generous. 85% of the cost of new ships was provided at 8% over a 12 year period with a two year moratorium on capital repayments, and funds were freely available. There was also direct subsidies of between 5.5% and 14% and generous tax incentives.

At the end of 1987 some US$ 1.6 billion of these domestic credits was outstanding, of which over US$ 600 million was overdue As a consequence, the Central Banco de Credito Industrial (BCI) is a significant owner of foreclosed tonnage (over 200 ships). A major co-operative restructuring initiative was established in 1988 with US$ 400 million funding, the intention being to create a new and workable framework which will be competitive when cabotage throughout the EEC is abolished (as planned). An extension is likely to be sought in this connection.

Capital gains on ship disposals, and 50% of undistributed profits may be held as tax free re-investment reserves.

Some companies are understood to be receiving operating subsidies on a temporary basis - "in the national interest".

5.8.3 SECOND REGISTRY

A request for a Canary Island territorial registry has been lodged. Dispensations from wholly national crewing have been requested.

5.9 WEST GERMANY

5.9.1 BACKGROUND

The number and tonnage of deep-sea ships owned benefically in West Germany under foreign flag now exceeds that under the domestic flag, and the proportion is increasing.

	Jan 1984	July 1987
German register	426 units	319 units of 4.2m dwt
Offshore	307 units	362 units of 6.4m dwt

The German coastal fleet has also been subject to flagging-out since 1986 when this was permitted under the dual registry laws.

A German shipowner may enter his ship in any foreign register, subject to repayment of any construction subsidies if the ship is under eight years old. Prior to this an owner may, however, claim financial hardship - in which case permission will usually be given for flagging-out under the dual registry/bareboat charter scheme, for an initial two year period. The usual method is to bareboat charter the ship to a subsidiary formed for that purpose in an appropriate jurisdiction using an appropriate flag - Cyprus is favoured, but several other registers are available, including Panama, Philippines, Honduras, Liberia and Vanuatu.

German seafarers are relatively highly paid; non-nationals are not supposed to be employed; and the steady appreciation of the deutschmark has made the West German flag uncompetitive in spite of major reductions in crew numbers.

5.9.2 FISCAL AND SUPPORT REGIME

Municipal taxes in the traditional maritime cities have compounded the federal taxation regime and resulted in the relocation of several well known German shipowners to Cyprus and Singapore. The German authorities are now endeavouring to impose German taxation on overseas resident businesses if Germans are employed.

The foreign earnings of shipping companies are subject to 50% relief on the first 80% if the earnings arise exclusively from offshore operations.

Investment incentives are attractive. The owner receives up to 20% of the price of a domestic new building as a shipbuilding differential grant. There are normal depreciation allowances plus an additional 40% on the post-subsidy price over the first four years. There is also rollover relief, and an 80% tax free reserve on capital gains on ship sales.

Much of the new investment in shipping (probably two thirds during the first half of the 1980s) has come from tax shelter investment partnerships (Kommandit and Partenreederie structures). 100% tax deferral was available until 1985 at which time the schemes were restricted.

5.9.3 SECOND REGISTER

Parliamentary hearings are underway examining a second register proposal. The proposal includes the use of German or European (EEC) officers and unrestricted crew, with the seafarers taken out of domestic taxation. Apparently, it would be open to German owners only.

5.10 NORWAY

5.10.1 BACKGROUND

The Norwegian flag fleet peaked at over 45 million dwt in 1975. Subsequently, it dropped precipitously to 13 million dwt in 1986. Over the same period the foreign-flag Norwegian owned fleet grew from 3 million dwt to 10 million dwt.

The Norwegian International Shipregister (NIS) was started in July 1987, and was extremely successful in its initial objective of arresting this tonnage loss:

flag	Norwegian		N I S		foreign		total	
	no.	m.dwt	no.	m.dwt	no.	m.dwt	no.	m.dwt
Jan 1987	550	10.7	-	-	417	13.5	967	24.2
Jan 1988	337	2.3	251	12.7	450	14.7	1,038	29.7

The NIS has attracted most of the larger deep-sea ships from the traditional register and has repatriated some of the foreign-flag vessels. The Norwegian owned fleet has been enjoying a significant expansion, whilst the rest of the traditional flags continue to contract, and this is undoubtedly due to the combined effect of the NIS and the K/S partnership vehicle.

5.10.2 SUPPORT SCHEMES

The domestic shipbuilding credit scheme provides 80% loans repayable over 12 years with a three year grace period and an interest subsidy. This is now academic as far as the deep-sea fleet is concerned as there are no Norwegian shipyards left

capable of building such vessels. During the shipping recession, the Norwegian government provided state guarantees to shipowners in order to stave off foreclosures and forced sales.

Tax free re-investment reserves are allowed, including all capital gains and half of undistributed profits. Roll over relief is also given.

The tax shelter partnership schemes (the K/S limited partnership) has provided most of the risk capital which has entered the Norwegian shipping industry over the recent years. Some 50% of Norwegian tonnage is now owned by these partnerships. It is estimated that there are 250 partnerships active in maritime projects involving some 10,000 individuals and US$ 3 billion in risk capital. Cuts in the highest rates of income tax, some significant investment failures, and threats of government restrictions on the more generous aspects of the K/S schemes have so far done little to dampen the enthusiasm. The banks and financial institutions in Norway have provided some very innovative structures around these K/S partnerships, and these have been marketed creatively.

5.10.3 SECOND REGISTER

THe NIS is an extension of the traditional Norwegian register in terms of operating standards, conventions and protocols. It also permits flexible crewing (even the Norwegian master's position can be waived for a foreign national). The Norwegian maritime unions have supported the move. Indeed they have been party to the crewing agreements which have been concluded with the representatives and national bodies of the foreign seafarers. Endorsement of these agreements has permitted unrestricted foreign trading for the subject vessels.

The combination of the NIS, as a vehicle for accessing cost effective factor inputs, and the K/S partnership, as a vehicle for accessing cheap risk capital, has undoubtedly restored confidence in the country's role as a maritime nation.

The NIS was also intended to attract foreign owners, but in this area there has been limited success. This is partially due to its limited value to a non-Norwegian company when compared to the alternatives. Another factor is that the ITF regards foreign ships registered under the NIS as operating under a flag of convenience.

5.11 SWEDEN

5.11.1 BACKGROUND

The Swedish merchant fleet was a major force in many shipping markets during the early 1970s. The fleet peaked at around 600 ships of some 12 million dwt. Most of the large tankers and bulk carriers which made up much of the fleet have been dispersed, and the fleet is down to some 2.4 million dwt. A further 5 million dwt is understood to be registered under foreign flags.

The divestment process created many casualties - including the biggest shipping company, Salinvest, and all of the deep-sea shipbuilding capability. The seafaring community has been reduced to some 12,000 in the deep-sea, short-sea and ferry trades combined.

Several Swedish companies are now significant operators in the offshore fleet consequent to aggressive asset trading policies.

5.11.2 SUPPORT SCHEMES

The domestic shipbuilding credit scheme, although still generous, is irrelevant as there are no active shipyards with meaningful deep-sea capabilities.

Tax free re-investment reserves are permitted and rapid depreciation allowances can be claimed.

Various measures have been discussed with respect to relief on seafarers personal taxation and welfare costs - with the benefits moving to the owner as an aggregate cost subsidy. These measures are up for reconsideration or implementation in 1989 depending upon political reconfirmation.

5.11.3 SECOND REGISTER

The Swedish seafarers unions are against the concept. The government has made commitments to find other methods of reducing operating costs through funding crew reduction research as well as tax breaks and more direct subsidies.

5.12 OTHER EUROPEAN INITIATIVES

Other European countries with lesser maritime involvements have recently introduced measures aimed at maintaining or promoting their commercial fleets.

The Finnish fleet has declined significantly with some 35 ships flagged out to the Bahamas. The seafaring unions have opposed concessions on crewing and are against a second register. A stalemate currently applies.

Eire has cut its corporation tax rate on shipping profits from 50% to 10%, and intends to introduce investment grants for shipping purchases as part of a programme aimed at major job creation throughout the maritime sector.

Portugal is under pressure from the Madeira Regional Government to approve a special register for the island as part of a tax haven business centre initiative. Similar proposals have been made for Macau.

The European Economic Community Commission is presently working towards a Common Transportation Policy as part of the barriers dismantling process intended for 1992. Cabotage, shipping conference policy, retaliatory provisions and shipbuilding form part of this discussion. A realisation that approximately half of the European/Asian crew cost differential arises from income tax and welfare payments has prompted some discussion on ways to ameliorate this burden, perhaps through a Common European Register. It is understood that there is major opposition to this concept within the Commission, and that one of the main proponents will not be involved when the issue comes up for serious deliberation next year.

6. INTERNATIONAL REVIEW - HONG KONG

6.1 BACKGROUND AND DEVELOPMENT

Originally a base for the British colonial shipping and trading houses, including the Swire Group and Jardine Matheson, Hong Kong became one of the main refuges for the Chinese merchant families fleeing the communist takeover of Shanghai in 1949. Hong Kong has provided these wealthy families with a benign business and political environment, one which has allowed them to conduct and develop their business interests internationally - virtually unfettered. Investments in mobile shipping assets owned through non-local subsidiaries became the method adopted to limit the potential exposure of wealth to any forceful, or negotiated, takeover of Hong Kong by the P.R.C.

The tremendous expansion of Hong Kong shipowning between 1955 and 1975 can be directly attributed to the relationship between the Japanese international trading community and the Hong Kong shipping families. This was the era of the "shikumisen" deal: an arrangement whereby a Hong Kong owner would order a vessel from a Japanese shipyard with the vessel's employment guaranteed for a significant portion of the life of the vessel (usually ten years) by a period charter fixed with a Japanese trading/commodity house or a Japanese shipping line. The arrangement provided Japan with an export order for its shipyards, plus secured longterm access to essential maritime transport - but without diverting limited capital and foreign exchange into an expensive asset with a lengthy payback period. Prior to 1975, Japanese shipowners were under administrative guidelines not to use foreign funding, and Japanese banks were forbidden to guarantee foreign loans. Utilisation of relatively expensive (and at one time scarce) Japanese crew was avoided.

On the other side of the arrangement, the Hong Kong shipowner was provided with a secure longterm "bankable" project, and access to cheap financing - both Japanese export facilities and Asian dollar market funds. Currency risks could be virtually eliminated by judicious cash flow matching. Inexpensive manning could be maintained through unrestricted access to international labour pools. Efficient, low-cost ship management was developed either in-house or through specialist ship management companies - including technical and risk management. In addition, the Hong Kong owners operated in a virtually tax free environment. As the volume of shikumisen deals grew, the Hong Kong shipowners were able to

exploit economies of scale and to become more adept in ship management techniques. The financial margins achieved were thin but stable. The growing fleets generated significant income levels, though gearing ratios became high.

The majority of the shipping investments entered into by the Hong Kong shipowners have been in the bulk sector - tankers and dry bulk carriers. This is partially due to the preponderance of Japanese bulk shipping charterers. Investments in liner vessels, and subsequently container ships and container systems, for independent operation have generally been avoided. In the context of the "mobile asset" criteria, modern container systems tend to involve extensive investments in infrastructure which are significantly less mobile than the ships themselves. The notable exceptions have been the Tung Group's Orient Overseas Container Line (OOCL), and Hong Kong Islands Line. Recent changes in structure of these two container lines, however, probably take them out of the "simple" Hong Kong grouping. It is understood that there are P.R.C. funds involved in the restructuring of OOCL; whilst Hong Kong Island Line may now be effectively controlled from the United States.

Changing market conditions brought the era of "wholesale" shikumisen new-building deals to a close. Increased availability of investment capital in Japan, and the lifting of foreign exchange restrictions, created a situation where the Japanese companies were able to arrange the offshore element on a competitive basis themselves, and without the need for the Hong Kong "middle-man". These developments did not eliminate the Japan/Hong Kong linkage, but the previously established procedure became merely one of several available alternatives. Many of the subsequent Japan/Hong Kong "false-shikumisen" arrangements were 50:50 joint ventures.

During the late 1970s and early 1980s, as the volume of Japanese business reduced, the Hong Kong owners entered into period charter agreements with other international charterers for both standard and specialised new buildings. At that time financing was readily available. In retrospect, the availability of funds is perhaps surprising as many of these arrangements were substantially more speculative than Hong Kong's traditional charter/build contracts with Japan. Some of the new charterers lacked both the financial depth and the robust trade base which had characterised most of the business with the Japanese charterers.

Whilst the Hong Kong owners had become adept at ship financing and ship management, the long term nature of their charter business had relieved the majority from the commercial demands of the spot market and insulated them from the normal cycles in the shipping market. But the prolonged depression in the tanker market (1974 to 1986 - for VLCC/ULCC tonnage) and the severe recession in the bulk trades (1981 to 1987) were not normal cyclical troughs.

Overall, several factors combined to create major difficulties for many of the Hong Kong shipowners from 1981 through to 1987. On the Japanese front, period charters of older technically inefficient ships were not renewed; whilst several Japanese oil tanker charterers were financially distressed to the point where charter renegotiation was the only alternative. Bankruptcy and the receivership of some major charterers (notably Sanko and Karlanda) resulted in an unscheduled reversion of ships to the Hong Kong owners. The exposure of the owners to the spot market was quite dramatic for those companies which had not maintained conservative positions. Spot and period business was only available at very depressed rates which barely covered operating costs, and made no contribution to capital costs. In addition, the affected Hong Kong companies did not have the necessary in-house spot market trading capability to achieve or better the prevailing market levels. As the situation worsened, widespread doubts concerning the solvency of the affected companies became a major impediment in securing substitute business with first class charterers. The result was some excessive risk taking and a rash of charterer defaults.

Unable to maintain the scale of their operations, retrenchment and down-sizing became the general rule for the exposed companies as they divested themselves of ships at distressed prices. For those with greatest exposure (notably Wah Kwong, the Tung Group, and Grand Marine) disruptive ship arrests followed. In the case of the first two owners, the creditors recognising the underlying worth and financial restructurings were eventually achieved in 1986/87.

Placing the above in its world context, it should be noted that Hong Kong owners proved to be no more exposed than owners in other traditionally shipowning countries - all of which suffered through the extended depressed markets with major casualties, e.g. Saleninvest of Sweden, Reksten of Norway, CAST of Canada, Sanko of Japan, United States Line, etc.

The market upturn in the bulk sectors which commenced in 1987 has provided welcome respite for the shipping community worldwide. In Hong Kong, profitable operations have been re-established for the restructured groups - justifying the faith of the creditors and owners in the underlying medium and long term value of the shipping assets involved. In addition, many of the owners who had cut their fleets significantly during the recession are now expanding with modern tonnage; and even the ultra-conservative owners (those who managed to escape the shipping recession virtually unscathed) are cautiously expanding as opportunities arise.

6.2 SHIPOWNERS AND MANAGERS

Establishing an accurate figure for the number of vessels owned, controlled or managed by Hong Kong entities is complicated by the presence of varying degrees of Hong Kong involvement and the associated potential for double counting and omissions. The unwillingness of some of the players to divulge information tends to inject an element of doubt into any quoted data.

Certainly, Hong Kong shipowners and managers own, manage and/or control an international fleet of ships totalling around 1,000 units. Lloyd's Maritime Directory (1988) lists over 110 Hong Kong companies which are purportedly involved with some 950 ships. The Hong Kong Shipowners Association (HKSA) membership contains 75 shipowners and managers, and the Association's latest Year Book (compiled end-1987) gives a figure of 1,099 ships owned and/or managed by members. At that time, the reported fleets of the HKSA members totalled some 50.5 million tonnes (dwt) and 28.75 million tonnes (grt).

LLoyd's Register of Shipping (Statistical Tables 1987) shows 409 ships under Hong Kong flag totalling 13.5 million tonnes dwt (HKSA figure 178 units for 8.1 million tonnes dwt); whilst UNCTAD estimated that the Hong Kong benefically owned fleet under other flags totalled 696 ships of 28.1 million tonnes dwt in 1987. Combining these figures suggests a total fleet under Hong Kong register and/or beneficially owned of 1,105 ships (which is close to the HKSA figure) but totalling 42.6 million tonnes dwt (as against the 50.5 million tonnes dwt figure provided by the HKSA). In this report, the HKSA figures will be used when considering the Hong Kong owned and/or managed fleet.

The Hong Kong fleet is operated under a total of 31 different registers with the Liberian, Panamanian and British (Hong

Kong) flags predominating (77% in aggregate). Graph 13 and Table 14 provide additional data in this respect. Numerically, bulk carriers are the most important ship type (476 dry bulk, and 176 tankers), followed by container/semi-container tonnage (184 units) and general cargo units (147).

The types of organisations involved in Hong Kong shipowning and management vary considerably. Some of the largest ones control fleets of 50 to 100 ships, and at least two are well known - the Tung Group (Island Navigation and Orient Overseas International), and the Pao Group (World-Wide Shipping Agency). The more typical Hong Kong shipowner, however, will control a fleet of perhaps 10 to 25 ships. In addition, there are a wide range of organisations which are the offshore shipping arms of organisations based elsewhere - in Japan, the United Kingdom, Israel, and South Africa, plus a significant P.R.C. involvement.

Several of the major independent international ship mangement companies (e.g. Wallem Shipmanagement, and Denholms) and a greater number of smaller ones are located in Hong Kong. The third party shipmanager sector also contains organisations which primarily offer manning agency services (i.e. crew supply).

6.3 MARINE SERVICES

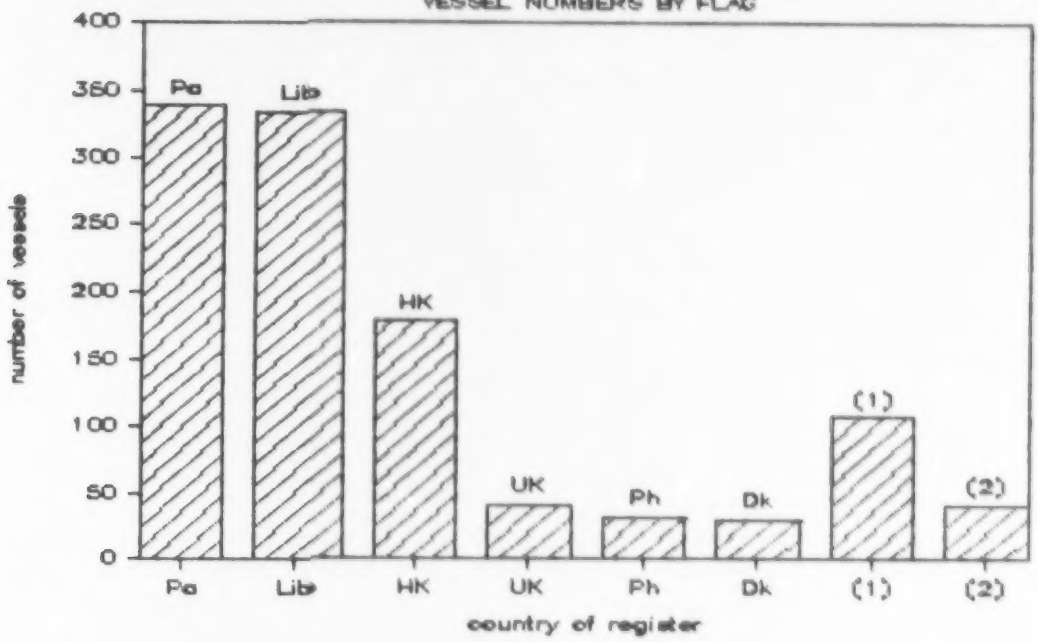
Based on its membership, it has been estimated by the HKSA that the Hong Kong international maritime industry - shipowners and maritime services - provides direct employment for 20,000 people in Hong Kong. This excludes the ship agency sector and the other port services which look after vessels actually calling Hong Kong.

The HKSA's total membership as at end-1987 stood at 152. There were 75 companies in the shipowners and shipmanagers category, with the balance in the maritime services sector: banks and ship finance houses (15), suppliers and other services (15), lawyers (10), ship and engine builders (8), classification societies (7), insurance and adjusters (11), plus shipbrokers, surveyors, accountants, shipbreakers, and publications. Some of these members would count the shipping industry as just one client sector whilst dealing with many. Conversely, there are many companies operating in the maritime services sector which are not members of the HKSA.

Whilst it was not possible to complete a detailed review of the maritime services sector, major components were examined in order to obtain indications of the economic spin-off from the Hong Kong maritime centre.

HONG KONG OWNED/MANAGED FLEET

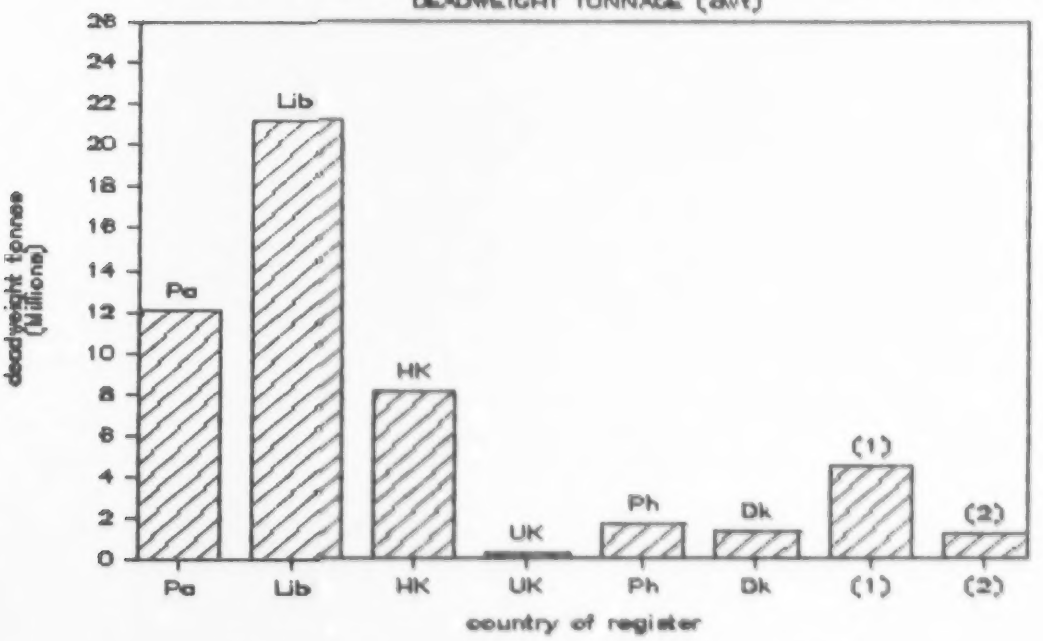
VESSEL NUMBERS BY FLAG



Graph 13A

HONG KONG OWNED/MANAGED FLEET

DEADWEIGHT TONNAGE (dwt)



Graph 13B

Pa:	Panama	Ph:	Philippine
Lib:	Liberia	Dk:	Danish
HK:	British (Hong Kong)	(1):	Other (10/20 ships)
UK:	British (United Kingdom)	(2):	Other (under 10 ships)

Adapted from: Hong Kong Shipowners Year Book 1987

TABLE 14

HONG KONG BENEFICIALLY OWNED FLEET - 1988

AGGREGATE VESSELS AND TONNAGE
OWNED AND/OR MANAGED BY HKSA MEMBERS AS AT 31 DECEMBER 1988

FLAG/REGISTER	VESSELS	D.W.T.	G.R.T.
ANTIGUA	1	7,831	3,936
ARGENTINA	1	13,939	10,484
BAHAMAS	13	408,977	246,819
BELGIUM	3	41,426	38,289
BERMUDA	1	15,243	11,415
BRITISH (GIBR)	4	1,322,748	655,271
BRITISH (HONG KONG)	178	8,111,141	4,881,940
BRITISH (IOM)	1	30,670	18,190
BRITISH (OTHER)	11	89,660	69,989
BRITISH (UK)	40	263,849	306,850
CYPRUS	10	307,727	169,148
DENMARK	30	1,321,399	1,096,113
NETHERLANDS	20	402,394	305,422
FRANCE	2	107,160	74,368
FRANCE (KERGUELEN)	2	160,229	91,106
GERMANY	2	24,958	18,311
ITALY	2	17,890	11,000
KUWAIT	6	109,076	68,648
LIBERIA	334	21,187,285	11,172,079
NORWAY	2	147,529	69,378
P.R.C.	10	134,647	76,184
PANAMA	338	12,115,839	6,942,351
PHILIPPINES	32	1,730,496	933,794
R.O.C.	17	1,157,074	708,460
S KOREA	1	18,835	17,676
SAUDI ARABIA	5	121,150	79,944
SINGAPORE	10	306,491	183,980
SRI LANKA	6	409,490	240,841
ST VINCENT	4	24,205	25,944
THAILAND	3	34,037	21,538
VANUATA	10	340,653	205,330
TOTALS	1,099	50,484,048	28,754,798

Source: Hong Kong Shipowners Year Book 1987

6.4 SHIP FINANCE

Hong Kong became a major centre for shipping finance during the 1970s, both in its own right and in conjunction with the major international ship financing centres of London and New York. At the peak of the ship lending cycle, it is estimated that the Hong Kong involvement consisted of the following: Eight to ten main lending banks with shipping portfolios in excess of US$ 200m, each with an established shipping unit headquartered in Hong Kong and consisting of industry specialists, loan officers and support staff. In addition, there were some 25 to 30 banks active in ship financing (directly and through syndication) which, although not maintaining a separately designated shipping unit in Hong Kong, did employ specialist and support staff to monitor, negotiate and manage shipping loan portfolios. Further, there were between five and ten specialist ship leasing companies based in Hong Kong, most of these having associations with Japanese shipyards.

In common with London and New York, the severe shipping recession of 1981 to 1986 decimated the Hong Kong ship financing community. A significant portion of their portfolios ceased to perform. In an attempt to maintain their security the banks were forced to foreclose on some loans, to seize and sell (or operate) vessels, and to participate in major corporate restructuring schemes. This experience, combined with the (understandable) dearth in new building financing business, has caused some financial institutions to vacate the sector completely. Others have taken a more sanguine approach, and are prepared to advance shipping loans selectively and on a restricted basis - especially if the business can be subsequently disposed of in the secondary market. The Hong Kong and Shanghai Bank has become a major player in both the direct and secondary ship finance markets and is understood to have a shipping portfolio of around US$ 1 billion.

It is estimated that the shipping loan portfolios presently managed in Hong Kong amount to between US$ 3 billion and US$ 4 billion. Probably 50% is directed to Hong Kong shipowners, 25% to Japanese shipowners, with the balance international. It is further estimated that the sector presently provides some 250 jobs in Hong Kong - substantially down on its peak of the early 1980s.

Shipping and ship building are volatile and highly cyclical industries; and, as a consequence, so is ship financing - for

both new buildings and second hand purchases. Most of the difficulties experienced in the shipping industry during the last 15 years be can traced to the excess supply of funds available for new buildings, due to national policies of shipyard support combined with the injudicious lending practices of many of the ship financing institutions in an overly competitive lending market. The lesson has, hopefully, been a salutory one. Although the ship finance sector has reduced substantially in size, shipping loan opportunities are probably better now than at any time during the years of heavy lending. As shipping itself continues to climb out of the trough, the ship financing sector will also expand - albeit with a pronounced cycle lag.

6.5 MARINE INSURANCE

Whilst the Hong Kong insurance market underwrites a great deal of non-marine business locally, it has very little marine capacity. Marine insurance is placed mainly in the London market, with some going to Europe, and a small amount to the U.S.A. The marine capacity in Japan is basically reserved for the Japanese market.

Shipowners demand attentive service which is best handled face-to-face on a local basis. Approximately 80% of hull and machinery (H&M) is placed through local brokers. Whilst 50% of the Hong Kong shipowner's Protection and Idemnity cover (P&I) is placed through local brokers - with the balance handled directly with the Clubs. Presently, only two of the major international P&I Clubs have offices in Hong Kong.

The premium income generated annually from marine insurance placed through Hong Kong is estimated to be in excess of US$ 250 million. The commission and investment income derived locally from this business would be in the region of US$ 25 million to US$ 30 million annually.

There has been a substantial increase in the number of insurance brokers operating in Hong Kong, mainly because international firms have selected the location as their Asia base. As a consequence, the amount of non-local business routed through Hong Hong is increasing substantially, whilst the competition for local business (especially in the reduced marine sector) is keen. Hong Kong and Singapore compete for other unrestricted marine business in Southeast Asia. To date, international broker penetration into the Japanese marine insurance market has been minimal. Singapore marine brokers have a good hold on their local market, including placements for associated Scandinavian tonnage.

The marine insurance sector - including brokerage, claims departments, P&I clubs, and average adjusters - probably provides employment for some 450 people in Hong Kong.

6.6 SHIP MANAGEMENT - IN-HOUSE

The majority of the Hong Kong shipowners provide ship management services in-house (i.e. with the managing agent in Hong Kong providing services to the nominally offshore owned vessel).

The number of staff employed depends upon the complexity of the ships operated, the methods of employment, the areas of trade, the extent of new building activity, size of operation and achieved economies of scale, and other factors. The numbers of shore jobs provided in Hong Kong by this type of operation (on a per ship basis) varies from a low of one per ship (long period time-charters); through four per ship (spot trading/mainly short time charters); up to a maximum of six jobs per ship (where there is a commodity trading operation associated with the ship management function). These figures do not include liner and container service operations which employ significantly greater numbers of staff, and where the ship managing function can also include liner agency work - swelling the numbers considerably.

6.7 SHIP MANAGEMENT - INDEPENDENT

In addition to the in-house ship management operations of the quasi-agency operations, there are some eight independent ship management companies of stature based in Hong Kong. These organisations manage between 300 and 400 ships primarily for non-Hong Kong shipowners. The services provided include technical, operations, crewing, accounting and risk management. It is estimated that these independent ship managers employ between 800 and 900 people in Hong Kong. In addition, there are large number of manning agencies which access Hong Kong, P.R.C., Filipino and other crews for international ship owners.

Hong Kong's role as a centre for independent ship management originally grew out of the ownership function. The demand was created by investors in shipping who had no expertise, or did not wish to set up, the ship management function, whilst some of the Hong Kong owners used third party ship management prior to establishing their own organisations. Japanese companies have also used independent Hong Kong-based managers as they moved away from the traditional shikumisen arrangements and

needed to establish themselves offshore. Most of the supply side of the equation came from organisations which had surplus ship management capacity because of the reduction or elimination of in-house shipowning/management operations.

Hong Kong provides the ship manager with an excellent logistical base from which to access those areas of Asia which are important in a maritime sense - i.e. ports of call, ship building and repair yards. It is also an ideal location for the operation and supervision of crewing agency functions in Asia - Hong Kong, P.R.C., South Korea, Philippines, Indonesia, Thailand, and Taiwan. The other important business environment factors for the ship manager are similar to those required by the shipowner - with a particular emphasis on simple and easy residency permit procedures for location of supervisory staff to Hong Kong, with unrestricted exit and re-entry thereafter.

6.8 OTHER MARITIME SERVICES

Ship broking is a fairly substantial sector in Hong Kong with some twelve major houses employing probably in excess of 100 active brokers plus support staff. The sale and purchase function (S&P) is quite substantial, with P.R.C. business figuring strongly. Charter broking has not developed extensively owing to the predominantly long-term nature of much of the business entered into by Hong Kong owners, and the limited local freight market.

There is a wide range of other functions provided to the Hong Kong shipowning and managing community by local firms. The marine function is a consistent and major user of legal services; ship purchase, financing, and employment contracts usually require extensive legal input; and there are many international wrinkles in shipping operations which generate the need for legal advice and action either directly or through the P&I clubs.

Other specialist suppliers include: classification societies, registration representation, ship and engine builders, representatives of offshore shipyards and suppliers of ship spares and stores, surveyors, crew travel specialists, naval architects, consultants and publishers.

6.9 TAX SYSTEM AND APPLICATION

6.9.1 PROFITS TAX

Hong Kong does not have a comprehensive income tax system. The Commissioner of Inland Revenue administers the Inland Revenue Ordinance for the Hong Kong government, which imposes taxes under four headings - profits tax, salaries tax, interest tax and property tax. There is no capital gains tax. Profit tax is charged against corporations in respect of business conducted in Hong Kong at a flat rate. The standard rate of profits tax is presently 17.0% having been reduced annually for the last three years.

> "..profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets).."
> (CAP 112. PART IV. s.14)

Profits tax is levied on a territorial basis. Using a "source test", only those profits which arise in or are derived from Hong Kong are chargeable to tax. The two general tests adopted by the courts in this connection are:

* Operations Test: Where do the operations take place from which the profits in substance arise?

* Contracts Test: Where was the contract from which the profits derive negotiated, concluded, and signed?

The application of these tests (when read in conjunction with CAP 112. PART IV. s.23) effectively exempts the operation of ships in international trade from assessment to Hong Kong profits tax providing the ownership is offshore, and the presence in Hong Kong is limited to an agency which does not exercise a general authority to negotiate and conclude contracts on behalf of its principal. (The shipowner may be assessed to a profit tax on freight generated outbound from Hong Kong - see Freight Tax, below).

As a consequence, the legal ownership of the ship will invariably be vested in an offshore company in an appropriate tax haven (in a British dominion if the ship is registered under the British/Hong Kong register). Charter parties will

be signed outside Hong Kong. Official board meetings will also take place offshore. The tax authorities follow and accept the legally documented chain as proof of the business being conducted offshore. A "mind and management" test is not applied.

The Hong Kong agency is assessed to profits tax in respect of the surplus on fees derived from the agency (management) function. A management fee of between US $80,000 and $100,000 per ship annum is a typical and acceptable figure, one which is in line with the fee charged by independent ship management companies.

Auditing is rare. Providing a company plays by the rules, investigations of marginal situations generally do not occur.

When the liberal taxation position is considered in combination with the free movement of funds in and out of Hong Kong it is obvious that the Hong Kong shipowner has considerable flexibility available to him. Funds accumulated offshore from shipping can be reinvested in offshore assets (shipping or otherwise) without any assessment to Hong Kong taxation. In addition, accumulated funds may be repatriated to Hong Kong without any concern regarding source or exposure to prior profits taxation.

As has been shown above, the taxation treatment of Hong Kong shipowners is relatively straight forward and generous, by most standards. In spite of this, however, tracing the beneficial ownership of a vessel through its nominal owning company can be extremely difficult, and potentially impossible. The arrangements made by many shipowners, whether Hong Kong Chinese, London Greek, or New York Israeli, are purposefully made as opaque as possible to shield beneficial ownership and associated wealth (or lack of it!) from organisations and countries with alleged claims (taxation or otherwise) see Figure 15.

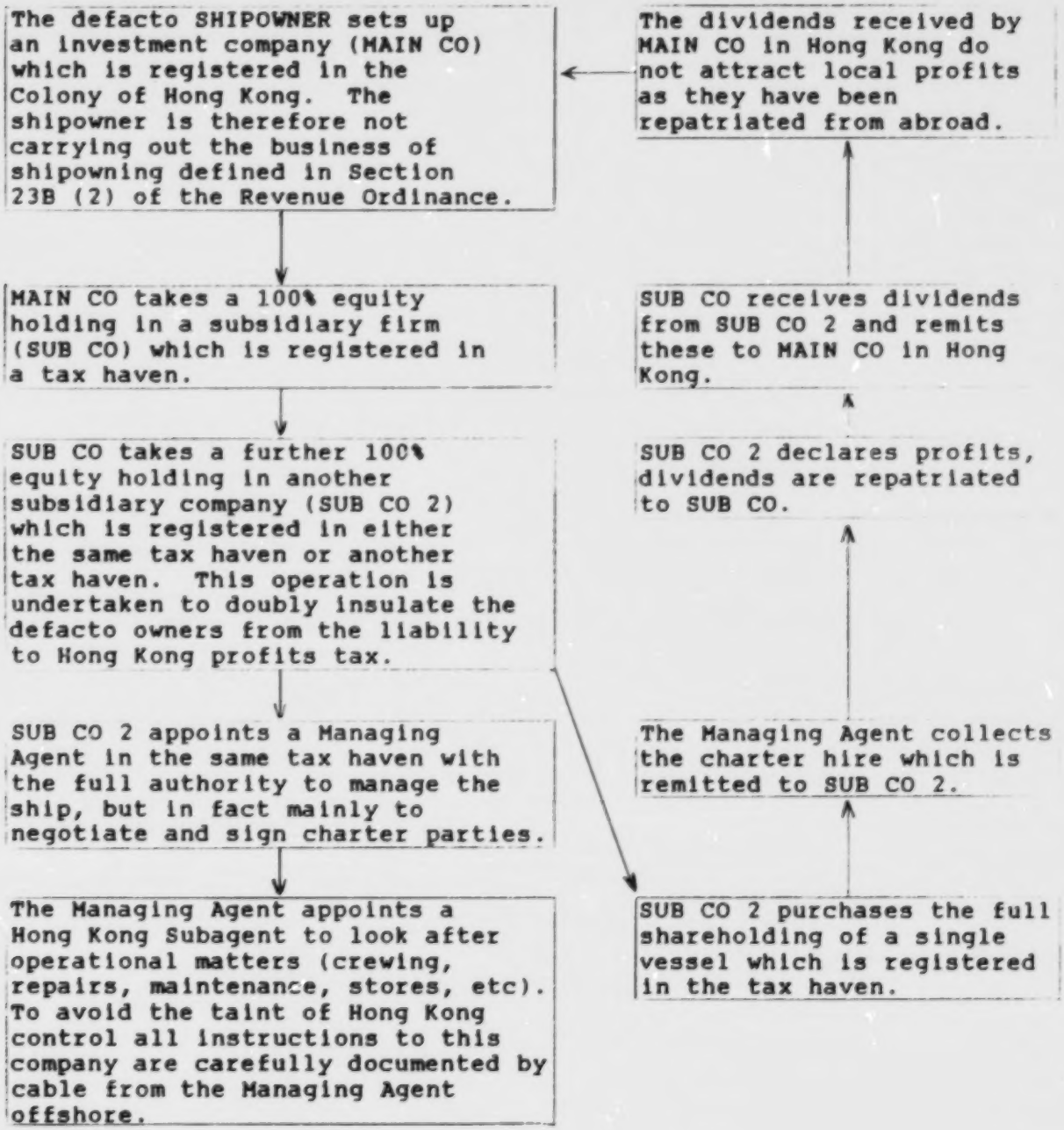
6.9.2 FREIGHT TAXATION

A profits tax may be payable by a shipping company engaged in the carriage of export cargoes from Hong Kong on a regular basis. The portion of deemed income to be assessed is taken in the ratio of the owners Hong Kong export freight revenue to the worldwide freight revenue of the company.

As few Hong Kong owned ships call at the port on a regular basis, this is not a significant factor in itself. On the

FIGURE 15

THE TYPICAL CORPORATE STRUCTURE OF A HONG KONG SHIPOWNER


The defacto SHIPOWNER sets up an investment company (MAIN CO) which is registered in the Colony of Hong Kong. The shipowner is therefore not carrying out the business of shipowning defined in Section 23B (2) of the Revenue Ordinance.
MAIN CO takes a 100% equity holding in a subsidiary firm (SUB CO) which is registered in a tax haven.
SUB CO takes a further 100% equity holding in another subsidiary company (SUB CO 2) which is registered in either the same tax haven or another tax haven. This operation is undertaken to doubly insulate the defacto owners from the liability to Hong Kong profits tax.
SUB CO 2 appoints a Managing Agent in the same tax haven with the full authority to manage the ship, but in fact mainly to negotiate and sign charter parties.
The Managing Agent appoints a Hong Kong Subagent to look after operational matters (crewing, repairs, maintenance, stores, etc). To avoid the taint of Hong Kong control all instructions to this company are carefully documented by cable from the Managing Agent offshore.
SUB CO 2 purchases the full shareholding of a single vessel which is registered in the tax haven.
The Managing Agent collects the charter hire which is remitted to SUB CO 2.
SUB CO 2 declares profits, dividends are repatriated to SUB CO.
SUB CO receives dividends from SUB CO 2 and remits these to MAIN CO in Hong Kong.
The dividends received by MAIN CO in Hong Kong do not attract local profits as they have been repatriated from abroad.

Note: As the vessel is fixed under time or bareboat charter any freight tax payable is the charterer's responsibility.

Source: The report of the Third Inland Revenue Ordinance Committee Hong Kong 1976.
Lloyds Shipping Economist August 1981.

other hand, it is this freight tax which has been the source of recent problems for Hong Kong internationally. Under the 1986 Tax Reform Act, the United States intends to apply its own freight tax to ships where the beneficial ownership is vested in a country which assesses American flag ships to a freight tax without the benefit of a reciprocal double taxation treaty or agreement.

Reflecting the laissez faire status of the Hong Kong economy, the Hong Kong authorities have no reciprocal taxation agreements whatsoever. The financial threat to the Hong Kong shipowning community from this new U.S. tax is considerable, and if not resolved will result in a mass exodus of shipowners from Hong Kong.

The creation of a double taxation treaty or an exchange of notes which would be acceptable to the United States has proved complex and time consuming. Inhibiting factors included:

* the ideology that taxation treaties run counter to Hong Kong's laissez faire ethos.

* initial difficulties in assessing the seriousness of either the intent of the U.S. or the impact on the shipowning community.

* the peculiar status of Hong Kong as it approaches 1997, which has meant that the governments of Hong Kong, the United Kingdom and the P.R.C. have all to formally agree to any internationally binding commitment of this nature.

As at the time of writing, it is understood that the only item outstanding is the formal agreement of the P.R.C. - an agreement which has already been given in principle.

6.10 HONG KONG 1997

Hong Kong will revert to P.R.C. jurisdiction on 1 July 1997. The official P.R.C. position is that Hong Kong will continue to function in its established laissez faire capitalist manner on the basis of "one country, two systems". Meantime, the P.R.C. is moving away (sometimes hesitantly) from a purely communist economic system.

Whilst the official position of those in authority in both industry and government tends to be supportive and optimistic, the unofficial Hong Kong position is one of scepticism. The

predominant attitude appears to be one which combines "wait and see" with extracting the most out of the existing freewheeling system - whilst making sure that personal "insurance policies" are in place. International asset diversification by Hong Kong business is large and growing (in Hong Kong it is being replaced by substantial offshore funds looking for Asian and P.R.C. footholds).

A substantial "brain drain" is taking place - officially placed at 20,000 in the last twelve months, but actually nearer to 40,000. This involves the loss to Hong Kong of those who can readily obtain immigration to desirable destinations - these are the well-qualified and better-off professionals. Canada is a favoured destination. Some of these emigrants plan to return to Hong Kong as soon as their "insurance policy" is in place (in Canada's case - three years residency as a landed immigrant to achieve citizenship). Others intend to settle permanently abroad. It is apparent that many of the first group (the temporaries) switch to the second (the permanents) during the qualifying period. Recent Hong Kong Chinese immigration to western Canada has contained a representative sample of experienced shipping personnel; probably 20 to 30 individuals, few have obtained employment in shipping-related activities.

Meantime, Hong Kong's domestic economy is booming, with unemployment a little over 2%, and shortage of trained personnel in many functions, with attendant wage escalation. The labour shortage is beginning to constrain the Hong Kong economy. Some banks have had to close branches due to staff shortages. The Hong Kong shipping industry has taken to advertising for personnel in the Canadian press! At least one maritime service company is establishing a Canadian operation in order to employ personnel, previously employed in Hong Kong, who are now resident in Canada.

Several Hong Kong shipowners and their families have become Canadian citizens over the last twenty years. Others have landed immigrant status and are seeking to accumulate the qualifying residency time for naturalization. Many have relatives established in Canada.

Tax consultants are known to have been retained by Hong Kong shipowners to examine the Canadian tax system with respect to viability of patriating the Hong Kong ship management/agency operation to Canada. The advice given has invariably been negative. Immigration to Canada creates major problems for the Hong Kong shipowner. Only by giving up control of the

operation (through sale, or by placing it in an offshore trust) can he avoid being deemed by Revenue Canada to have moved the "mind and management" of the total shipping owning operation to Canada.

6.11 ALTERNATIVE VENUES

As a group and individually, the Hong Kong shipowners recognise the advantages which the colony bestows upon them. Ideally, they would prefer to remain where they are. On the basis that an alternative location may have to be found, the preference would be for one which provides them with a comparable business environment. Various locations are making overtures, and some of these combine ship registration facilities and tax exemptions for resident ship ownership - Singapore and Cyprus. Other locations under consideration are basic tax havens - Monaco, the Channel Islands, etc.

Singapore is regarded as the most likely candidate, though many Hong Kong owners have reservations, mainly of a political nature. Apparently, the tax structure also incorporates some negative factors.

Through the interview process it was established that at least one shipowner/manager, who has extensive Japanese connections and probably funding, is systematically examining the Singaporean scenario through occasional visits and discussions with government officials, political and business contacts. He is also visiting other Asian countries, as the opportunities arise, in order to make comparisons, to keep up to date with national and regional developments in this context and, perhaps, to cultivate interest on the part of the respective authorities.

7. INTERNATIONAL REVIEW - THE UNITED STATES OF AMERICA

For the last fifty years the U.S.A. has had two very distinct merchant fleets, the American-flag fleet and the Effective United States Controlled Fleet (the EUSC). The flag structure of the American owned fleets are detailed in Graph 16 and Table 17. The EUSC fleet consists of those vessels which are beneficially owned by nationals of the U.S.A. and registered under foreign flags. Strictly, the flags available to the EUSC are those which have been endorsed by the U.S. Navy and the U.S. Maritime Administration (MARAD), and where there is inter-governmental agreement that permits the U.S. government to requisition the flagged-out ships owned by U.S. citizens in time of war or national emergency. Ships of the EUSC fleet may be entered into the Liberian, Panamanian, Honduran, and (recently) the Bahamian registers. In addition, however, an American benefically owned ship may be registered under other open registers. Emergency requisitioning is then handled through a voluntary agreement between the U.S. beneficial owner and the U.S. Department of Defense, reinforced by underlying legislative powers.

7.1 THE U.S. FLAG FLEET

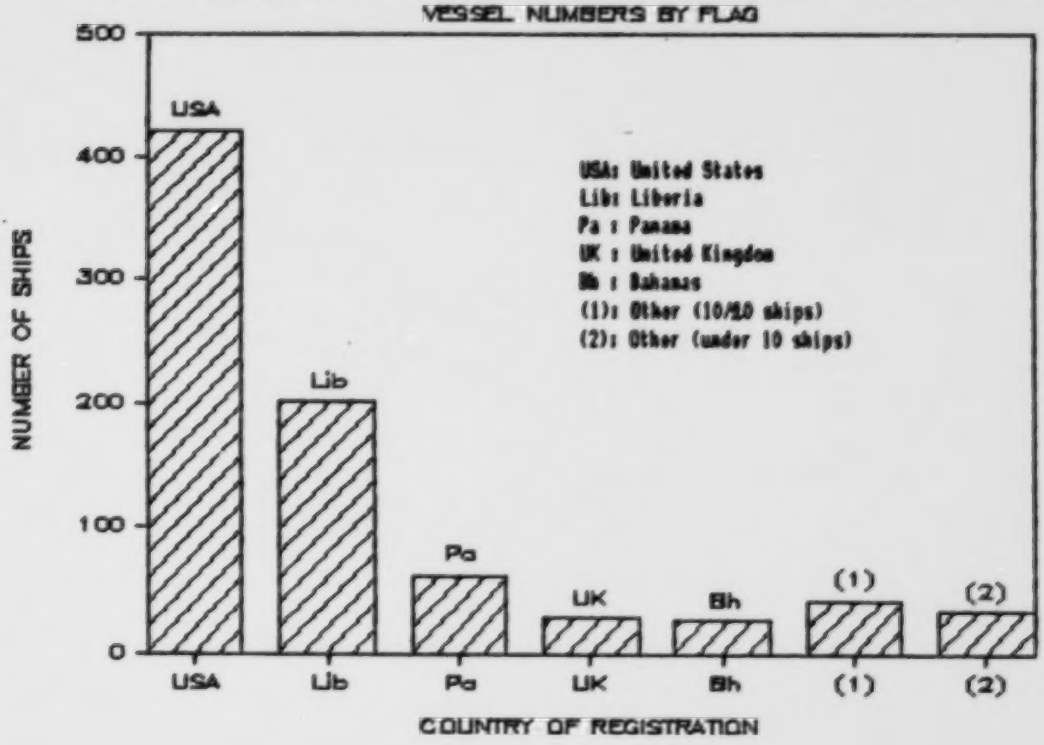
The total American-flag fleet has declined from some 900 vessels to about 650 vessels over the last ten years, although the deadweight tonnage has increased by some 29% over the same period. A large number of these ships are employed directly by the U.S. military or are part of the U.S. reserve fleet. The Military Sealift Command (MSC) has over 120 ships under its ownership or charter, whilst MARAD controls some 120 ships in the reserve fleet, of which there are 90 in the "ready" reserve fleet on a maximum 10 days readiness. It is estimated that there are some 400 ocean-going American-flag ships under private ownership.

The circumstances surrounding the American-flag fleet are extremely complex, consequent to support schemes and associated restrictions. These programmes are under the jurisdiction of the U.S. Maritime Administration. The ground rules of these schemes have changed frequently over the last few years and have also been subject to extensive litigation. In principle, and subject to many recent qualifications, for a ship registered under the U.S. flag must be American-owned, legally and benefically, American-built and American-manned.

An American-flag American-built ship operating in non-restricted trades qualifies for a construction differential subsidy (CDS) which recognises the high relative cost of

US BENEFICIALLY OWNED DEEP-SEA FLEET

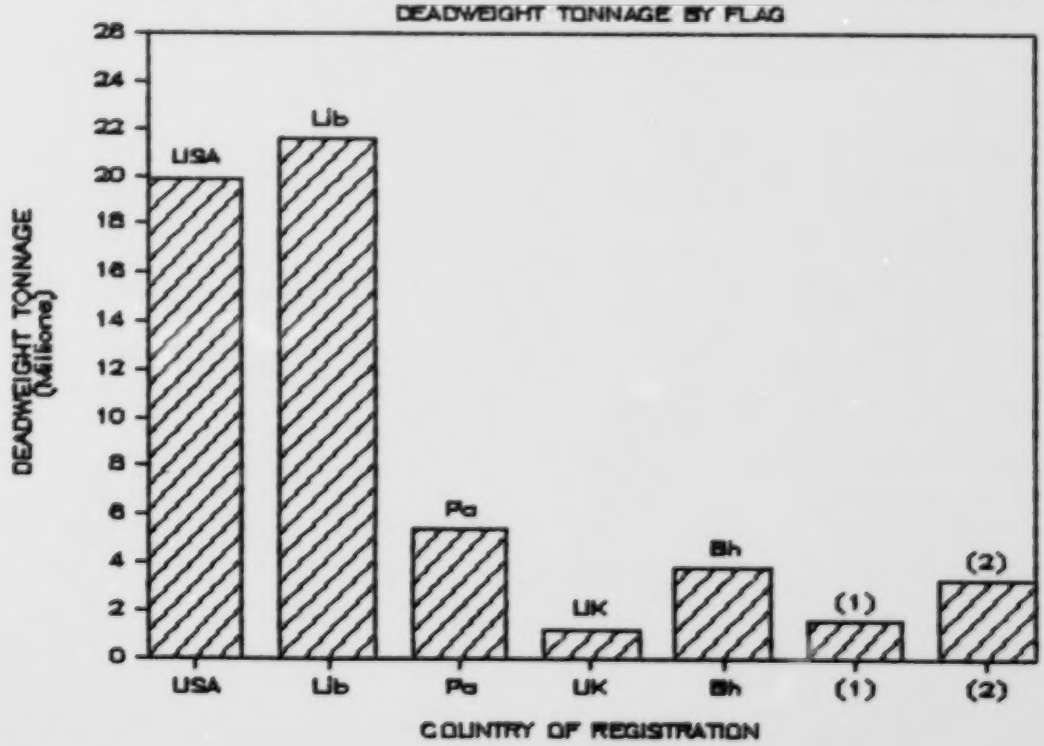
VESSEL NUMBERS BY FLAG



Graph 16A

US BENEFICIALLY OWNED DEEP-SEA FLEET

DEADWEIGHT TONNAGE BY FLAG



Graph 16B

TABLE 17

AMERICAN BENEFICIALLY OWNED FLEET
U.S. AND OFF-SHORE FLAGS

BY COUNTRY OF REGISTRATION - 1987

FLAG/REGISTER	VESSELS	D.W.T.
Argentine	13	392,837
Bahamas	26	3,817,704
British dependencies	20	871,784
Canada	2	16,653
Cyprus	2	4,139
F.R.G.	1	11,214
Finland	1	6,954
France	8	1,493,163
Greece	3	27,823
Honduras	3	21,335
Japan	1	2,962
Liberia	201	21,567,626
Netherlands	3	388,187
Norway	4	113,303
Panama	62	5,382,527
Saudi Arabia	4	1,110,130
Singapore	10	286,741
South Africa	1	31,102
United Kingdom	28	1,207,942
United States	422	19,909,596
Vanuatu	1	41,262
Totals	816	56,704,984

Sources: Maritime Reporter June 1988, MARAD

building a vessel in a domestic shipyard. The CDS remains available, but has been restricted to 50% of the contract price since 1970. As U.S. shipyard prices are approximately triple those quoted by foreign yards, the CDS is insufficient to generate any new building interest in the U.S.A.

An operating differential subsidy (ODS) may also be paid to an American-flag shipowner in recognition of the high relative cost of employing American seamen. The ODS is restricted to American built ships and authorised foreign-built ships. The ODS covers approximately 75% of crew wages and benefits, and can amount to between US$ 2 million and US$ 4 million per ship annually. ODS is usually limited to ships which have been authorised for use in specified international liner trades. In 1970 the subsidy programmes were extended to bulk carriers, the new building target was set at 300 ships, but under 50 were actually built. New ODS approvals are currently frozen, and it is understood that the subsidy may be phased out over the next twelve years.

Government generated cargoes (military and aid) are essentially restricted to American flag ships (75%), and may be further restricted to ships which are also benefically owned in the U.S.A. Unsubsidised American flag vessels are permitted exclusive access to the U.S. coasting trades (under the Jones Act or the U.S. Passenger Shipping Act, as appropriate). Exceptions have been permitted recently, however, and the use of three large subsidised tankers in the Alaska oil trades has resulted in an erosion of rates, and litigation by non-subsidised operators.

The Merchant Marine Acts are scheduled for a major overhaul sometime in the next two years. Progress is expected to be slow and difficult because of the strength of the vested interests within the U.S. maritime lobby (shipowners, shipyards, and maritime labour unions). Competitive and strongly held views will continue to prevent the formation of a clear and cohesive support policy.

The distortions created by this regime are considerable:

* The continued operation of old ships is encouraged, and the superficially indefensible rebuilding of old American-origin hulls is commercially attractive.

* Since 1985 only eight ocean-going commercial vessels have been delivered by the U.S. yards, and all of these were built for the reserved coasting trades. There are no merchant vessels under construction in the U.S.A. today.

* Freight rates in the coasting trades are maintained at high levels. This results in the routine diversion of cargoes and passengers and the creation of subverting foreign-flag operations.

* The cost of cargo reservation under the Jones Act and the government cargo restriction has been estimated in the region of US$ 3 billion per year, with the Alaska crude oil route accounting for some US$ 2 billion.

* It is estimated that the U.S. Treasury provides some US$ 250 million annually in ODS, whilst the Title XI loan guarantee programme has cost over US$ 2 billion in recent years.

* The system contains many actual and perceived inequities which generate a great deal of litigation, resulting in legal rulings which are frequently contrary to established administrative policy, causing extensive and often debilitating confusion.

Justification for the system is based on strategic defence criteria and employment considerations - as they relate to the availabilities and capabilities of American ships and shipyards, and their associated labour pools.

7.2 THE AMERICAN FOREIGN-FLAG FLEET

As noted above, the subsidy scheme consolidated by the U.S. Merchant Marine Act of 1936 did not extend subsidies to American-flagged bulk ships. As a consequence American owners, faced with uncompetitive costs under domestic flag, began to make extensive use of the Panamanian and Honduran registers. This trend was encouraged by the administration after 1939 as a method of aiding the transportation of military supplies to the United Kingdom and France when the use of American-flag vessels was prohibited under the Neutrality Act.

In the post-war years, the importance of the bulk carriage of commodities such as oil, ores and grains increased dramatically. Consequently, the relative importance of bulk carriers in the world fleet expanded. The U.S. owners, and especially the international oil companies, were in the forefront of this trend; one which took place under foreign flags. The Liberian register was formed in 1948 specifically to fit the requirements of the U.S. beneficial owner.

Support was provided to the foreign-flag U.S. owner by the U.S. government through a fiscal policy which only taxed the income and profits from these offshore operations when they were repatriated to the U.S.A. The EUSC was accepted by the military authorities as being part of the U.S. merchant marine in its capacity as the "fourth arm" of the military service. The amount of the U.S. beneficially owned deadweight tonnage under foreign-flags grew significantly with the development and introduction of large crude carriers (the VLCC and the ULCC) into the oil trades during the late 1960s and 1970s - a development pioneered by American foreign-flag owners. American offshore ownership peaked in 1979. It dropped by some 40% over the next eight years as the worldwide shipping depression forced some owners out of the business and others to contract. As at 1987, MARAD estimated that U.S. companies were the beneficial owners of 394 ships totalling some 36.8 million tonnes dwt registered under 20 different flags.

The corporate structure adopted by the American foreign-flag owners involves offshore subsidiaries which legally own the ships. Liberia, Panama, and subsequently the Bahamas and Bermuda were the favoured jurisdictions for the owning subsidiaries. The legal offshore owner then appointed an agent in the United States to manage and control the commercial and ship mangement functions onshore.

The ethos of the structure was international freedom of access to ships, capital, registers, and crew within a tax free environment, one which could not be provided under American-flag.

7.3 THE TAXATION SYSTEM

Prior to 1976, the income generated by foreign-flag shipping operations benefically owned by U.S. citizens resident in the U.S.A. was not subject to U.S. taxation until the earnings were repatriated. At that time, the tax laws were changed so that earnings could only remain effectively tax free so long as they were re-invested in shipping or related assets - under Subpart F. This appears to have been a very specific policy which recognised the value of EUSC operations to the U.S. economy. Subsequently, this was further restricted so that the reinvestment had to take place during the current year. The 1986 U.S. Tax Reform Act effectively revoked this deferral through reinvestment. Taxation in the current year may now be avoided only if the foreign corporation is not a Controlled Foreign Corporation (a CFC). A foreign corporation is considered to be CFC when stock representing more than 50% of

its voting power or equity value is owned by U.S. persons who each own stock representing 10% or more of the corporation's voting power.

The 1986 change was apparently a consequence of some eleventh hour congressional "horse trading", it did not involve extensive policy analysis nor was it supported by the administration. The provision was subsequently maintained, however, justified under the equity arguments which seem so prevalent in modern tax reform worldwide.

The consequence for foreign-flag shipping, beneficially owned and controlled by Americans, is that future purchases of ships will have to be made from post-tax funds. In a capital intensive industry, in which foreign owners are able to invest in ships using tax free or tax exempt and tax deferred funds, the change places the U.S. owner in an obviously uncompetitive position.

All of the perceived solutions result in the loss of legal control in the U.S. The favoured route involves joint ventures with foreign partners and the divestment of sufficient equity so that the foreign shipowning subsidiary ceases to be a CFC. Some U.S. oil companies are known to view the necessary partial divestiture move as containing such major disadvantages and risks that long term time chartering from unconnected organisations is considered a better course of action. Some of the smaller organisations have suggested that they expect to maintain effective control through careful offshore structuring which satisfies the CFC provision in the U.S.A. but maintains U.S. control as far as the offshore jurisdiction is concerned. A further route for the individual owner is to give up U.S. residency, and probably to renounce U.S. citizenship.

It is certain that the EUSC will be progressively reduced as earnings are subject to taxation and new ships are not ordered. This trend will be exacerbated by the disposal of existing ships and the devolution of control to non-American controlled onshore and offshore joint ventures. The EUSC lobby has been working hard for changes to the Act, but success is unlikely. It is anticipated that no action will be taken until such time as major disposals have taken place and the full impact on the strategic availability of U.S. controlled merchant fleet is apparent to the military and the Congress. The present Commission on Merchant Marine and Defense (COMMAD) has not recognised the importance of the issue. Its second report to the President (January 1988) saw

the solution to the lack of strategic capacity as an expansion of the American-flag fleet through further protection, intervention and subsidy. Five of the seven members of COMMAD have direct ties to the U.S. merchant marine or shipbuilding interests.

7.5 THE TREATMENT OF FOREIGN SHIPPING

A foreign shipping company which is beneficially owned outside of the U.S.A. may be operated from the U.S.A. by a managing agent. The foreign business will only be subject to taxation on the income which is effectively connected with a trade or business conducted in the U.S.A. under section 882 of the Act. Under sections 872(b) for individuals and 883 for corporations, foreigners are exempt from taxes on the gross income derived from the operation of ships in respect of business in the U.S.A. providing the country in which it is organised grants an equivalent exemption to U.S. citizens and corporations.

A comparison of the U.S. foreign-flag beneficial owner's position with that of the U.S. based (but legally offshore) foreign-flag owner:

> although they are conducting the same business in the same manner from the same location, the U.S. beneficial owner will be taxable in the U.S. whilst the foreign beneficial owner will not.

Further, providing the foreign owner is legally constituted in an appropriate tax haven, or in a tax favourable jurisdiction, his aggregate cost of operation, in which there are no significant tax costs, will be substantially less than that of the American owned operation, which is subject to taxation.

In the extreme instance the foreign owner may be in a position through the (improper) use of bearer shares to be effectively a U.S. owner and evade taxation on his worldwide shipping income.

7.6 TAXATION OF U.S.-DERIVED GROSS TRANSPORTATION INCOME

Prior to the 1986 Tax Reform Act, the U.S.A. did not impose any taxation on income derived from international transportation in respect of business originating or destined for the U.S.A. American ships were, however, subject to freight taxes in a wide variety of countries, usually on the basis of an immediate tax levied on the gross freight receipts

for export cargoes against the carrier of record. The American-flag lobby requested their government to take action; either to force the assessing countries to remove these taxes, or to impose American taxation in respect of U.S. business undertaken by ships operating under the flags or ownership of the offending countries.

The 1986 Tax Reform Act contained a section (883) which provided for taxation of the gross income derived from the operation of ships in respect of U.S. origin/destination business. Exemption would be granted by virtue of reciprocal agreements and treaties. The tax quantum was 4% on 50% of the gross transportation income - i.e. an effective 2%. Regulations were not issued for some considerable time, and are still in draft form although the first tax returns had to be filed in early 1988. This provision created tremendous confusion and concern throughout much of the open register shipping world.

The intended system went far beyond the normal method of freight taxation assessment in locating the party to be taxed. The intention was apparently to bypass the nominal carrier in order to assess taxation against the beneficial owner. As many of the countries of nominal and beneficial ownership did not have reciprocal tax agreements (including Hong Kong, Singapore, Panama, Liberia and Cyprus), the threat was taken very seriously once its potential scope was realised. The result has been a flurry of negotiations, new double taxation treaties, and exchanges of diplomatic notes. The main shipowning jurisdiction currently outstanding is Hong Kong (see Hong Kong section for further details).

As the U.S. action appears to be achieving its objective (i.e. the exemption of American-flag ships from foreign freight taxes on a worldwide basis), it is probable that this section of the Act will not need to be enforced. Consequently, the system of assessment, collection and enforcement may never need to be established.

7.7 GREENWICH CONNECTICUT

During the course of setting up, and conducting the interview programme for the eastern United States, it became apparent that the number of shipping companies and maritime service groups located in Greenwich is currently growing quite rapidly. Greenwich and Stamford have been home to a handful of both U.S. owned and foreign owned ship management/

shipowning companies for some years - entities such as Skaarup Shipping, Stolt-Neilsen, MooreMac Marine, and several shipbrokers.

The original impetus for locating in Greenwich 15 or 25 years ago, rather than New York, was the absence of state taxes (15% in New York), relatively low office rents, reasonable prices for good quality housing in the immediate vincinity, hassle-free travel between home and the office, and easy access to the city. The results manifested themselves in good staff morale and low establishment costs.

The original advantages of locating in Greenwich have largely disappeared. The "village" is extraordinarily expensive to live in or near, rents have escalated, many staff members now have to commute long distances (some into, and then out of New York). But shipping companies and maritime services continue to move in.

The Connecticut Maritime Association (the CMA) started off as a social gathering for the local maritime community. It has now progressed to a more formal role; organising industry seminars, social and sporting events, luncheon speakers, and producing an informative news letter which is now in its fifth year.

There are 366 individual members of the CMA - although some of these do not work in Greenwich. Membership is weighted in favour of maritime services, but there is a strong contingent of marketing and operations people from shipowning and operating groups. There is a strong international element as the majority of the ship operating companies are the U.S. operating/managing agents for offshore owners.

Time precluded a detailed investigation of real numbers, service spin-off and economic impact on the local economy. Geography, cost, lifestyle were the starting points. Subsequently, Greenwich achieved a certain "critical mass" so that it continued to grow even though many of the original factors had disappeared.

Discussions with people associated with the CMA was obviously stimulating for both sides. The CMA is now preparing a questionnaire to establish "who we are, why we are here, and what the CMA should be addressing". One can only regret that the answers were not to hand at that time!

8. INTERNATIONAL REVIEW - OTHER CENTRES

The inclusion of maritime activities as a significant feature in development programmes designed to achieve international business status for cities and countries is relatively common. Usually this has been associated with the creation and promotion of a ships register. Examples include Bermuda, Bahamas, Cyprus, Luxembourg and Singapore. Other shipping centres have developed or have been maintained because of specific tax treatment policies for shipping, or general tax policies which have accommodated shipping activities. Hong Kong, London, New York, Switzerland, Monaco and others can be included in this category.

A limited number of these centres have been examined for comparative purposes.

8.1 SINGAPORE

The Singapore flag is generally regarded as a flag of convenience. A Singapore flag ship must be owned by a citizen or permanent resident, or by a company constituted under Singaporean law. The corporation may be foreign owned. A Singapore resident must then be appointed as manager, but in practice this can be a nominee who acts solely as a communications channel.

Profits generated from Singapore-flag ships operating in international trade are exempt from Singaporean taxation in the hands of the shipowning company, but may be taxable when distributed as dividends - subject to taxation treaty provisions for foreign owners. Foreign owned companies based in Singapore which operate foreign-flag ships will be exempt from taxation on the offshore activities of these ships providing income is not repatriated and the onshore activity is limited to ship management on an agency basis.

Although the above scenario seems superficially similar to the one which prevails in Hong Kong, apparently there are differences which extend the potential tax exposure.

Singapore has a special taxation regime to attract foreign companies to locate their regional headquarters on the island, this involves concessionary tax rates which reduce the normal corporate rate from 33% to 10%.

The Singapore authorities recognise the economic value of foreign and domestic marine activities. They have been

successful in attracting Norwegian and West German interests to opt for Singapore flag and to base shipowning and managing activities in the country. There has been some discussion between the authorities in Singapore and certain Hong Kong shipowning interests aimed at creating a modified fiscal framework acceptable to both sides.

8.2 CYPRUS

Cyprus is engaged in a development programme aimed at increasing the amount of offshore business conducted from the island. A reduced tax rate on profits is applicable and dividends paid to offshore interests are tax free. In addition, there are extra tax incentives for newly established offshore interests. Although the country is attempting to avoid a tax haven label, there does appear to be a great deal of brass-plate business involved. The total number of offshore companies which have physically established on the island runs to around 600, and includes a number of Greek and West German shipowning and management companies.

The amount of tonnage under Cypriot flag has grown very substantially over the last two years to about 1,900 ships totalling 15 million grt. Dual register provisions have been a significant factor in this growth - especially for West German owners. The flag has a poor and longstanding reputation for high casualty levels, lax standards and inept administration, which the new maritime administration is furiously endeavouring to rectify.

A special Adviser on Maritime Affairs has been appointed reporting to the President, and a higher international maritime profile is being sought. A marketing programme is underway aimed at owners in Hong Kong, Japan and elsewhere. Development of the maritime services sector figures strongly as an objective.

Major negative factors include the high cost and adequacy of the island's communications network; the ban on Cypriot vessels at Turkish ports; and the premiums applied to various port and other charges by miscellaneous national authorities worldwide on Cypriot ships.

8.3 THE BAHAMAS

The Bahamian registered fleet amounted to 720 ships of 10.2 million grt at the end of 1987. It is now a major open register. The chief users have been European owners (75%),

with U.S. owner levels falling below expectations despite of approval by the U.S. Navy of the flag for EUSC inclusion.

The flag is viewed as a generator of income in its own right. The island has attracted some shipowners to set up their international headquarters under the tax free conditions which prevail. Most found the business environment unworkable and left. Poor communications, restrictive immigration practices, unacceptable/expensive living conditions, plus the incidence of corruption were the factors found unacceptable. Most of the shipping companies registered in the Bahamas are brass-plate entities. Several individual shipowners maintain the island as their official residence for tax purposes.

8.4 BERMUDA

Bermuda has a large international business sector which combines a mixture of actual, nominal and brass-plate presences. The captive insurance sector is by far the largest element, with banking second, and shipping running a distant third. Britain's oldest colony, it offers political stability, a tax free/low tax environment, good communications and adequate air transport links (two hours to New York).

International business has been estimated to generate half of the islands GDP (US$ 656 million out of US$ 1.28 billion), it employs 6,000 people of which a quarter are native Bermudan.

As at June 1988, the Bermudan register amounted to 119 commercial ships of 3.75 million grt. The fleet has grown substantially in the last year, a result of a decreased fee structure, and the protection afforded to Bermudan flag ships by the British navy in the Persian Gulf. The Bermudan flag is part of the British registry, and the island's authorities are working closely with the U.K government to extend the important maritime safety and pollution conventions to the dependent register. An updating which will improve its acceptability worldwide.

Although the legal domicile of a large bevy of shipowmners, the actual presence on the island is limited. The legal entities include Gotaas-Larsen, and Canadian Pacific (Bermuda) Ltd. Individual residence is maintained by Erling Naess, Per Lorentzen and the Kulikundis family. The Hong Kong trading house Jardine Matheson domiciled its legal headquarters in Bermuda as of 1984.

When Canadian Pacific established their bulk shipping head office in Bermuda, the company received an undertaking from the Bermudan authorities that their activities would not be assessed to Bermudan taxation before the year 2006. This exemption was granted under the Exempted Undertakings Tax Protection Act of 1966, as amended.

8.5 LUXEMBOURG

A Luxembourg Second Register is contemplated as an additional feature of the financial services sector. This area has grown prodigously as a result of Luxembourg's tax, banking and business environment. Foreign investments in Luxembourg are tax free and the disclosure laws permit extensive secrecy. Luxembourg's captive insurance business now rivals that of Bermuda, whilst there are some 600 banks and financial institutions registered in the dutchy.

The impact of European universality scheduled for 1992 has not been assessed, but it could progressively undermine much of the present business advantage which Luxembourg enjoys.

The main impetus behind the second register has come from Belgium. The initiative is presently bogged down with the Belgian unions. Several Belgian shipping companies have indicated that they will promptly flag into Luxembourg as soon as the register is formed.

9. INTERNATIONAL REVIEW - CANADA

9.1 BACKGROUND

The total Canadian registered fleet consisted of 1,238 ships of 3.5 million dwt in 1987. It is one of the most elderly fleets in the world, half is 20 years old or more. Of this fleet, some 70 units have ocean-going capability and these account for 925,000 dwt. In this context, ocean-going includes ships which are able to trade within extended home trade limits but may not be classified for, nor physically capable of, international deep-sea operations. It also includes ships which are not traded outside the eastern seaboard of North America simply because of selected trading patterns.

The ocean-going Canadian-flag fleet has declined from 83 to 70 ships over the last three years (see Graph 18 and Table 19 for additional details). Over half of this reduction is due to either reclassification of vessels to inland waters trade (2 units) or transfer to foreign-flag under Canadian beneficial ownership (6 ships). Three companies which were traditionally Great Lakes traders now own some nine ships under foreign-flag and this trend is a growing one; these are the only Canadian shipping companies which operate ships under both domestic and foreign flag.

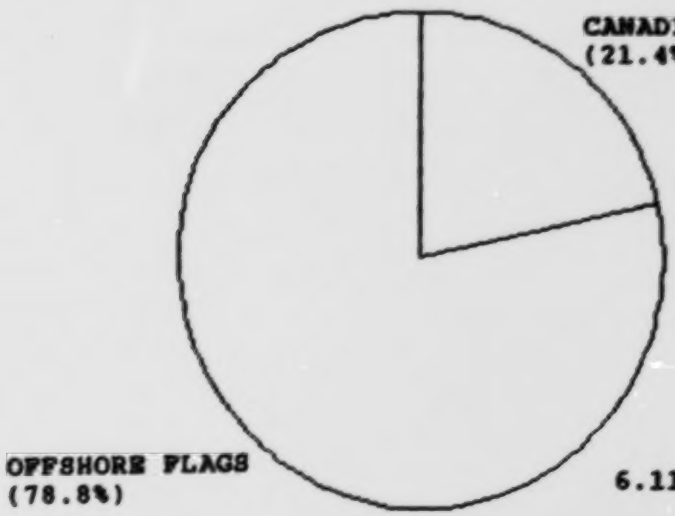
With the exception of some limited "niche" markets the Canadian-flag fleet either continues to trade in the protected cabotage trades, or it moves into deep-sea international trade and flags-out. The Canadian-owned foreign-flag fleet is entered under nine different flags, new and traditional open registers, plus a significant Belgian contingent.

The number of ships and the amount of tonnage under foreign-flag Canadian beneficial ownership has shown a very steep decline over the last three years with the departure of about one third of its strength (some 60 ships) and over half of the deadweight tonnage (a reduction of 2.5 million dwt). This decline is a result of significant reductions in the Canadian Pacific and Fednav fleets. Canadian Pacific made a strategic decision to vacate most of the bulk cargo trades in order to limit the unpredictable and severe impact of this volatile sector on the company's overall performance. This decision was largely implemented in 1987 through the en bloc and individual sales of nearly 30 ships. Over the same period Fednav, under pressure from the continued shipping recession, disposed of some ten ships - though some these were chartered back. Transport Canada's figures show that there are currently twelve foreign-flag Canadian shipowners. In 1984 the two

FLEET COMPOSITION — CANADIAN CONTROL

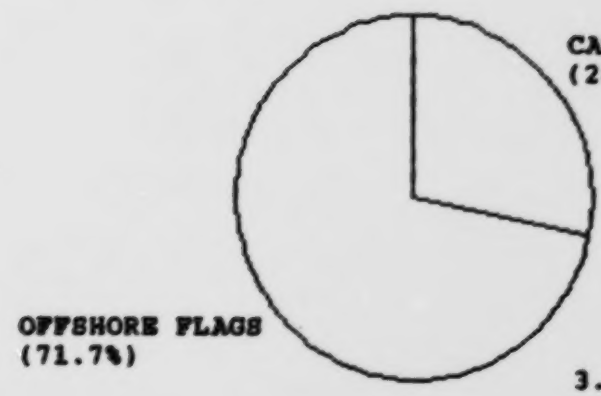
REGISTRATION - DEADWEIGHT BASIS

Graph 18



1984

6.11 MILLION TONNES DWT



1987

3.27 MILLION TONNES DWT

TABLE 19

CANADIAN FLAG AND CANADIAN CONTROLLED FOREIGN FLAG FLEET - WITH OCEAN-GOING CAPABILITY
1984 AND 1987

	1984		1987		CHANGE	
	#	dwt	#	dwt	#	dwt
CANADIAN FLAG	83	1,304,396	70	925,348	(13)	(379,048)
OFFSHORE FLAG	97	4,804,894	53	2,341,911	(44)	(2,462,983)
TOTAL	180	6,109,290	123	3,267,259	(57)	(2,842,031)

Source: Transport Canada: The Canadian Flag Deep-Sea Fleet 1987-88

Notes:

Most ocean-going capable Canadian flag ships are employed exclusively in inland waters, the Canadian coasting trade, or on the eastern Canada/USA coast. Very few are employed in the deep-sea trades.

Those Canadian owned vessels, previously under Canadian flag, and regularly operating in the deep-sea trades have flagged-out.

companies mentioned above controlled over two third of the ships and three quarters of the tonnage. Whilst these small samples and dominant positions make it difficult to generalise, the actual downsizing of the Canadian foreign-flag fleet has echoed worldwide trends in fleet structure over that period.

9.2 CANADIAN TAXATION OF INTERNATIONAL SHIPPING

9.2.1 RESIDENT CORPORATIONS ENGAGED IN INTERNATIONAL SHIPPING

In general, corporations resident in Canada are taxable on their world income. All corporations formed in Canada after 26 April 1965 are deemed to be resident in Canada. Credit may be given for foreign taxes - providing the business is carried on in whole, or in part, in Canada.

A corporation, although not formed in Canada, will be deemed resident if its "central management and control" is in Canada (also referred to as the "mind and management" test) and its income will be subject to Canadian taxation.

It is the twin concepts of "mind and management" and the taxation of world income, as they are applied to international shipping, which largely differentiates Canada from other developed and developing countries which have, or aspire to, interests in international shipping.

9.2.2 NON-RESIDENT CORPORATIONS

Under section 81 of the Income Tax Act, non-resident corporations which derive income from business carried on in Canada are, generally, subject to taxation in Canada on such income. However, such a non-resident corporation will be exempt from Canadian taxation on income derived from international shipping if the country in which the corporation is resident provides substantially similar relief through treaty, or if there are relevant reciprocal relief provisions under Canadian legislation. If the country of residency of the offshore corporation does not impose a tax on income, the non-resident corporation will also qualify for reciprocal relief - as if that income was in fact taxable but subject to relief by legislation or treaty.

9.2.3 TREATMENT OF FOREIGN SUBSIDIARIES

The foreign subsidiary or affiliate of a Canadian corporation engaged in international shipping operations will not be

subject to Canadian taxation on its income, providing its residency is in an appropriate country and providing it is not deemed resident in Canada under the "mind and management" test.

9.2.4 THE TREATMENT OF REPATRIATED DIVIDENDS

Under section 113(1)(a) a Canadian resident corporation can deduct from its taxable income those dividends received from a foreign affiliate's exempt earnings provided:

* the Canadian corporation holds at least 10% of any class of equity in the foreign affiliate (section 95(1)), and

* the earnings are exempt under Regulation 5907 by virtue of the affiliate being resident in a listed country and the income derived from active business.

9.3 EXPATRIATION OF "MIND AND MANAGEMENT"

9.3.1 THE CANADIAN PARENT

Because of the above tax treatment, a Canadian corporation wishing to participate in international shipping will:

* form an offshore subsidiary resident in a listed country, and,

* to ensure that the subsidiary will not be deemed resident of Canada, it will move its "mind and management" offshore.

In this manner the income of the subsidiary will not be subject to Canadian tax either at the subsidiary level or on repatriated dividends.

Transfer of senior management offshore will also avoid the secondary possibility that Revenue Canada will deem the foreign corporation to be an agent of the Canadian parent. The result of this being the attribution of a portion of the income of the foreign subsidiary to the Canadian parent, based on the value of services rendered by senior management in Canada to the offshore subsidiary.

9.3.2 THE OFFSHORE COMPANY OPERATING IN CANADA

Foreign companies engaging in international shipping, and which are exempt from Canadian taxation on Canadian derived income

through legislation or treaty, may also be caught by the "mind and management" test if any senior management personnel are located in Canada. In this instance, with the offshore company deemed resident in Canada, it is the company's world income from all sources which is potentially liable to Canadian taxation, and not just its international shipping income.

9.4 THE CONSEQUENCES

As tax exempt regimes are obtainable for international shipping operations outside of Canada, a Canadian company will only maintain the "mind and management" of its international shipping in Canada if

* international shipping is an insignificant proportion of total business, and/or
* the company has insufficient management resources to commit to offshore operations, and/or
* it is not in an aggregate taxable position, and/or
* there are overwhelming personal or business reasons to remain in Canada.

For an offshore corporation, engaged in international shipping (which will be operating in a benign fiscal environment - almost by definition), and which wishes to open or maintain an office in Canada, it will ensure that

* the management staff and functions located in Canada will be involved in Canadian based operations only, and
* the Canadian operation will be remunerated on an agency or commission basis which will not raise questions of unfair transfer pricing.

In a world in which unprotected international shipping operates effectively tax free, Canada's fiscal regime as it applies to this industry can only be described as hostile and internationally uncompetitive. As a consequence, Canadian international shipping operations are largely organised offshore. In addition, foreign organisations which have a basic interest in operating internationally from Canada (or expanding the scope of their international operations based in Canada) are effectively prevented from doing so.

9.5 THE CANADIAN SECOND REGISTER PROPOSAL

The Dominion Marine Association (the DMA) in conjunction with the Canadian maritime unions put forward a proposal for a second (or parallel) Canadian register. This proposal has received serious consideration by Transport Canada, and the Department issued a discussion paper on the subject in September 1988.

The following measures are proposed:

* Entry to the register would be restricted to Canadian-owned and Canadian-managed ships.

* Second register vessels would not be permitted to operate in the Canadian coasting trades.

* Canadian ship safety and construction programmes would apply in the normal manner.

* Second register vesels would be restricted to Canadian crews, with existing bargaining units guaranteed.

* Canadian nationals employed on the ships would be exempt from Canadian personal income taxes. These "effective" savings would be passed on in their entirety to the owner to defray operating costs. The net income of the seafarer would therefore be maintained.

* Earnings from second registry operations would be free of corporate income tax both at source and in the hands of Canadian parent companies.

* There would be simple procedures for transfer between the two Canadian registers. i.e. to ease the transfer of deep-sea ships from the international to the cabotage trades in response to changing market circumstances.

* Current pilotage exemptions and waivers would be maintained for qualified masters of second register ships.

It is understood that the Ministry of Finance is very much opposed to the proposal.

According to the discussion paper, it has been estimated that the personal income tax measures proposed would reduce the estimated differential between a Canadian crewed vessel and a

foreign-crewed vessel from approximately C$ 1 million to C$ 415,000.

In this context, Transport Canada's "Deepsea Vessel Cost Study" February 1988 estimated that Canadian crewing costs for a 60,000 dwt bulk carrier were C$ 654,000 more than a U.K. flag vessel and C$ 1,183,000 more than a comparable Liberian flag vessel (see Table 2). Using these figures, the measure would reduce the annual advantage of the Liberian ship to C$ 598,000 and almost eliminate the advantage of the U.K. flag ship - to C$ 69,000. It should be noted, however, that the U.K. flag and U.K. national crewing are no longer internationally competitive (see Section 5.1)

The interest in the second register can be expected to come from Canadian shipping companies which own and control ocean-going ships capable of operating in both the international and domestic trades. Logically, the Canadian owner must also intend to operate the ships in both trades. If a vessel operates only in the domestic trades it cannot qualify for second register status. If a vessel only operates in the international trades, then the ship will more likely be placed under a foreign-flag, in accordance with current practice, in order to be competitive.

International experience suggests that a second register will attract ships owned by nationals from both the traditional national register and from foreign-flags only if the second register permits flexible, non-national crewing arrangements.

Factors in the Canadian Great Lakes trade may perhaps create a rather unique situation to which such a second register might cater. The number of shipowners and ships that are likely to avail themselves of the opportunity is small.

> "..to be effective such a flag has to be a fully international competitive vehicle and not a boutique operation that benefits four owners and ten ships." [Acres International, Seascope summer 1988. The Flag Market].

9.6 COMPARISON WITH THE "ISC" PROPOSAL

The International Shipping Corporation proposal put forward by the Task Force on Deep-sea Shipping does not exclude the operation of any flag (Canadian, Second Register, or foreign). It also seeks a tax free exemption at the corporate level in the same manner as the Second Register proposal.

The Canadian crew content of the Second Register has resulted in labour support for the proposal. Conversely, exporters are major supporters of the ISC proposal, and as a group vehemently opposed to any measure which might reduce freedom of access to internationally competitive ocean transportation.

The ISC Proposal and the Second Register proposal have tended to be viewed as mutually exclusive and competing. This is not the case. The Second Register, as proposed, should be viewed as a subset of the ISC Proposal.

PART 3

THE

INTERNATIONAL

MARITIME CENTRE

1. THE INTERVIEW PROCESS

107 interviews took place during the investigative part of this work, including 14 telephone interviews. In total, there were 147 interviewees. The organisations concerned were selected on the basis of the target groups and geographic distribution. Coverage was as follows:

	western Canada	eastern Canada	western U.S.A.	eastern U.S.A.	Hong Kong	Europe	total
aggregate interview data							
contacts	54	23	18	16	30	6	147
interviews	34	18	12	13	25	5	107
cargo shipowners /managers/operators	15	11	10	9	21	5	71
cruise lines	-	-	6	-	-	-	6
exporters	17	3	-	1	-	-	21
maritime services	16	2	2	3	3	1	27
associations	2	1	-	3	1	-	7
others	4	6	-	-	5	-	15

The European interviews were undertaken as part of a sub-consultancy package let to a United Kingdom maritime specialist. The remaining personal interviews in Canada, the U.S.A. and Hong Kong were conducted by members of the Canadian consulting team.

In order to obtain constructive responses, especially with organisations where shipowning and operating was the primary business, it proved essential to interview the owner himself, a very senior official, or a close strategic adviser. Intermediaries were used where direct previous contact had not been established. Generally, the access achieved to these senior people was very good, once the nature of the project was understood in principle. This was particularly so in the cargo sector, and especially in Hong Kong.

Written pre-advice of the content of the project, and an appropriate interview format was despatched to most of the contacts, copies of these documents appear as Appendix A. Because of the nature of the subject, the interviews tended to be wide ranging, and some very different perspectives and priorities were noted.

2. THE DESIRABLE BUSINESS ENVIRONMENT FOR INTERNATIONAL SHIPOWNING AND MANAGEMENT

The following is a list of those features of a business environment which were considered essential or desirable for shipowning and management activities by the various individuals/organisations interviewed:

2.1 GENERAL PRINCIPLES

laissez-faire

a minimum amount of rules, which are not subject to frequent change

political stability

2.2 SHIP REGISTRATION AND CREWING

no restrictions on the flag/registry of owned/operated ships

no restrictions on manning

acceptance of the prevailing jurisdictions (as above)

2.3 COMMUNICATIONS

competitively priced, reliable and accurate international communications: telephone, fax and telex

good direct international air access

2.4 QUALITY OF LIFE

pleasant living conditions

cultural and ethnic tolerance

affordable good quality housing

internationally competitive living costs

a non-corrupt, non-violent environment, with an established work ethic

2.5 **GEOGRAPHY**

a centralised location in relation to trading patterns:

- cargo, cargo interests, ports of call, ship repair and shipbuilding yards

a workable time zone

2.6 **MARKET**

easy access to the market place, i.e. proximity to established shippers, charterers and information

proximity to a regional freight (and passenger) market

the existence of a "marine community"

2.7 **ACCESS TO SERVICES**

a world class business centre

financial:

- good access to shipping finance, banks, institutions and financial markets
- competent and rapid banking transactions: especially international money transfer
- unrestricted foreign exchange transactions

competent maritime services:

- legal, insurance, shipbroking, etc

2.8 **MEDIUM AND LONG TERM GROWTH PROSPECTS**

bouyant development outlook

2.9 **LABOUR**

access to an expert labour pool - to fill positions requiring specialist qualifications/experience

access to a competent labour pool - for general positions

good working attitudes

non-militant labour force

2.10 ESTABLISHMENT COSTS

internationally competitive office/establishment costs

labour, office space and services

2.11 IMMIGRATION & WORK PERMITS

immigration status for

the foreign shipowner and dependents

key personnel and dependents

flexible and rapid access to work permits for foreign staff

simple and quick entry, exit and re-entry formalities

2.12 FISCAL REGIME

a tax-free or tax-exempt corporate fiscal environment

a flexible personal tax regime for the entrepreneur shipowner

3. VANCOUVER - COMPARISON OF ATTRIBUTES

The interview process established those features which were considered of particular value by shipowners, managers, and operators in their current business environment. It then went on to ascertain what factors would be considered either essential or desirable if the organisation was (hypothetically) looking for an alternative location.

These features are listed in the previous section. The actual business environments for Vancouver, British Columbia and Canada were then considered in the light of these findings. The interview process also shed some light on how Vancouver is perceived in various parts of the shipping world.

3.1 GENERAL PRINCIPLES - LAISSEZ FAIRE

International shipping operates in a commercial environment which has been under an extreme revenue squeeze for many years. The result has been intense competitive pressure and the achievement of factor inputs at least cost on a trans-national basis. It is probably the only industry in the world which has the general capability to bypass nationally oriented restrictions and to take advantage of offered incentives as available, i.e. to avoid or enjoy regional distortions.

Shipowners make very substantial investments based upon lengthy payback periods in a volatile commercial environment. Current, representative capital commitments for assets with an expected lifespan of 15/20 years are:

US$ 32 million for a new Panamax bulk carrier
US$ 60 million for a new building large tanker
US$ 200 million for a new building cruiseship

These projects are very sensitive to potential changes in the operating rules which can undermine long term viability, e.g. the elimination of Subpart F re-investment deferrals for U.S. owned foreign-flag ships. Uncertainties in Canadian tax legislation, and the concept of "negotiating" the assessment with the authorities after the event, are viewed with concern.

Canada is regarded very favourably from outside for its political stability - in the broadest sense. Canadian residents and organisations with more knowledge of the Canadian scene point to major changes in policy positions (e.g. FIRA and the NEP) as creating difficult precedents for the success of an initiative of the type under discussion.

3.2 SHIP REGISTRATION AND CREWING

Those trading centres which provide the shipowner with:

* a fiscally benign environment,

* the ability to select the ships register based on the relative advantages of available flags, and

* the opportunity to crew his ships based on the cost effectiveness of the alternatives available,

are the ones which attract and maintain an effective international shipping industry.

Hence, the United Kingdom and the U.S.A. have been favoured by the foreign shipowner. Hong Kong, Singapore and more lately Cyprus, have become major locations for both the domestic and the foreign shipowner. Whilst those traditional maritime nations which now offer a flexible second register, combined with major fiscal incentives for shipping investors - such as Norway and Denmark - appear to have established an internationally competitive environment for their domestic shipowners.

To quote the tanker division of a major oil company:

> " (we require)...the minimum amount of hassle from a registry..not to be told by the registry that (we) have to use a particular crew on particular terms and conditions...(we) live in a competitive world and (that means we) need commercial freedom. (We) will look after the standards of operation ourselves..(without) bureaucratic interference."

A ship operates under the national jurisdiction of the country of registration (i.e. the flag state). The agreement under which the crew are employed comes under the jurisdiction of the country of registration, and may also be subject to the jurisdiction of the country in which the engagement was made. This position has been accepted in courts worldwide. Other countries have some jurisdiction over the operating standards and performance when the ship is in its territorial waters (i.e. the port state).

* A change in the Canadian business environment for international shipowning and management which attempts to include any additional elements of Canadian jurisdiction over the operation of a foreign-flag, foreign-crewed vessel is unlikely to be internationally competitive.

3.3 COMMUNICATIONS

Canadian communications are excellent. The associated costs are reasonably competitive on an international basis - slightly more expensive than the U.S.A., rather more expensive than Hong Kong.

Vancouver's international air access was considered to be generally adequate by most contacts. Several U.S.-based cruise lines, however, with extensive Canadian experience consider that

* Vancouver has major drawbacks when compared to U.S. locations. The negative features include limited trans-border flights and more difficult access to some locations when compared to the main U.S. hubs.

3.4 QUALITY OF LIFE

From those who are aware of the city there is considerable enthusiasm.

The Hong Kong Chinese regard western Canada as a very receptive and tolerant location, with established cultural links.

The importance of British Columbia's attractions as a place to live should not be understated in a trans-national and individualistic industry. There are several Canada-based ship operators who logically should be elsewhere, but remain because of personal lifestyle preferences.

The accompanying Table 20 (Comparative Economic Statistics - 1988) compares various price, cost and earnings indices for some of the major business and shipping centres internationally. The cost of living in Canadian cities compares favourably with the U.S.A., Europe and Japan; price levels in Singapore and Australia are not dissimilar. The net purchasing power of an employee in Canada is significantly greater than the other centres - excepting Los Angeles. Housing costs in Vancouver, though increasing for some sectors, remain very competitive.

From an aggregate cost of living standpoint, Vancouver is a very attractive location for employees.

TABLE 20

COMPARATIVE ECONOMIC STATISTICS - 1988

	A	B	C	D	E	F	G
	price level (index) (a)	gross wages (index) (a)	working hours (hours/yr) (b)	paid vacation (days/yr) (b)	purchasing power net (index) (a)	apartment rental (US$/m) (d)	office gross rent (US$/sqft)
HONG KONG	57.4	19.5	2,672	7.6	40.7	3,850	68
SINGAPORE	66.5	15.5	2,060	17.2	21.4	1,990	32
TOKYO	158.6	67.2	2,013	16.1	44.2	9,510	176
LONDON	80.2	57.9	1,754	24.1	65.4	2,290	158/134 (c)
OSLO	115.1	74.5	1,697	22.8	38.8	1,190	n/a
LOS ANGELES	60.5	73.1	1,917	14.2	117.6	1,080	30
NEW YORK	79.9	67.9	1,867	13.0	74.1	2,500	47
CANADA (e)	68.8	63.3	1,838	17.0	83.0	1,100	35 (f)
SYDNEY	66.9	46.7	1,768	20.0	66.2	820	52

Sources:
Columns A thru F - Union Bank of Switzerland - prices & earnings around the globe
Column G - Colliers 1500 3/1988 - Office Market Survey Sept & Oct 1988

Notes:
(a) index based on Zurich = 100
(b) average of 12 professions
(c) city/west end
(d) medium priced 4 room European style accommodation
(e) average Toronto, Montreal and Vancouver as available
(f) Vancouver = US$ 30/sqft

Comments:
Personal life style/cost columns - C,D,E and F
Office cost columns - B,C,D,E and G

3.5 GEOGRAPHY

Vancouver represents a good central location for some ship trading patterns. For an organisation involved extensively in both sides of the Pacific, it is the most favoured North American location. It has no attractions for a shipowner/manager operating predominantly in the Atlantic basin. Access to shipyards (Japan, Korea, and Singapore) is good by North American standards, but obviously compares unfavourably with Hong Kong.

The reaction to the implications of Vancouver's time zone in relation to Europe, eastern North America, Japan and South East Asia is provocative. It draws out major negative and major favourable comments in almost equal proportions and from all sectors of the industry - owners, brokers, exporters, etc. Certainly it is possible to work all time zones, if required. To do so, however, is socially intrusive. Restricting business activity to a 0900 to 1700 working day with lunch at 1200 renders Vancouver out of step with everywhere. Improved communications (fax machines in residences, etc.), and the 24 hour working patterns of many international businesses may reduce the hostile reaction, over time. This factor is less important for organisations which maintain chartering/marketing offices in the major international trading centres.

3.6 THE MARKET

The "market place" means very different things to different operators. Some shipowners located in New York/Greenwich or London cannot envisage a location which would place them at any distance from the trading centre in which their customers participate and make their daily sales and freighting decisions. Whilst daily telephone communications can be maintained from distant locations, there is a perceived need by some operators to be within easy personal contact distance - whether or not this is a regular occurrence.

For a cruise line, there is a demonstrated preference to be located in one of the main marketing regions in the U.S.A. - California, Florida, and New York. There is also a major "image" aspect associated with this sector of the industry which seems to dictate a Los Angeles, San Francisco, New York or Miami head office location. The media, advertising and public relations capabilities of these centres reinforces this focus.

Whilst Vancouver is the major gateway for the Alaska cruise trade, Canada is not a major source of passengers (some 3% in recent years). Marketing factors will continue to dictate the head office location for cruise lines, at least while the U.S.A. continues to treat these (predominantly) foreign operators favourably from a fiscal standpoint.

British Columbia is a major generator of neo-bulk and bulk cargoes totalling some 90 million tonnes annually. It is a major regional shipping market, second to New York in North America, which has developed to service those sectors of the trade which sell C&F - primarily forest products, but increasingly sulphur, potash and other commodities. There are at least five, genuinely foreign shipowners for whom British Columbia is a major commercial and operating hub. The existence of this large freight base provides an additional attraction for a shipowner with trade diversification in mind.

The "marine community" provides the supply side of the freight equation. It is the concentration of this community relative to the demand for its services which creates the "market" for the negotiation and fixture of freight contracts.

There is a "critical mass" factor at work here, which can result in the creation of a shipping centre which continues to grow because an important international market place has developed. Those without a local presence in the market become marginal participants and realise that they are missing opportunities.

A marine community also creates the opportunity for useful sectoral activites - industrial associations, training schemes, international meetings and forums, etc.

Vancouver has a regional marine community, but it has a narrow domestic focus - one where shipping agency business predominates.

3.7 ACCESS TO SERVICES

Vancouver has aspirations to achieve world class status as an international business centre. The successful attraction of international shipowning and management to the city will assist in this evolution. At present, it does not compare favourably as a developed centre with the locations which have attracted international shipowners. The English law basis of the legal system is an important positive factor.

The maritime services sector in Vancouver has developed to service regional demand. It represents an established core of expertise which has the capability to respond fairly rapidly to the additional demand which an international shipowning/ managing community might place upon it. There are some areas which currently do not exist (ship financing), others which are less well developed (marine insurance), and some which are quite well established (shipbroking).

* As one of the main objectives of this proposed initiative is the development of the maritime services sector, the existence of a workable base should be viewed as a very positive attribute, and the current limitations need only be temporary.

For some shipowners (especially in New York) daily personal contact with the financial markets was considered imperative; to the point where even a relocation from New York to Greenwich would not be contemplated. This factor may become more important for some owners if the present trend towards innovative ship financing continues to grow - syndications and partial flotations for example. Other owners did not view this as critical, and pointed to the rapid development of the Hong Kong ship financing community during the 1970s in response to the burgeoning demand for shipping loans.

3.7.1 THE INTERNATIONAL TRANSFER OF FUNDS

International ship operating is very dependent upon the quick and accurate movement of large sums of money internationally. The failure of the banking system to transfer of funds at short notice can easily result in the costly detention of a ship in a foreign port. Similarly, there have been many instances of ships being withdrawn from charter, especially in a rising market, because hire monies were not received in the designated bank on time.

* There was a litany of complaints from those organisations with experience in western Canada concerning delays in the international transfer of funds. Complicated routings (via Toronto/New York), limited tracing capability, and a lack of appreciation of the need for speed and accuracy were the main factors raised.

  The western Canadian banking community must become much more responsive in this area if Vancouver is to become competitive.

3.8 MEDIUM AND LONG TERM GROWTH PROSPECTS

For organisations with a Pacific Basin orientation Vancouver is viewed as having tremendous potential as a focus for international business development.

3.9 LABOUR

3.9.1 SPECIALIST SKILLS

The availability of workers with specialist shipping skills is considered a major factor in the choice of location. It has been relevant in the recent location choices of several new cruise lines. In the cargo sector, Vancouver was regarded as having a reasonable supply of regionally oriented commercial and operating (cargo) personnel.

* Some skills were considered potentially in short supply - such as low speed marine diesel supervisory experience, basic ship management experience.

Several owners/managers with Hong Kong connections suggested that it would be very simple to assemble a good ship management team in Vancouver drawing solely on recent Hong Kong Chinese immigrants with recognised shipping skills.

3.9.2 GENERAL SKILLS

The availability and educational standards of non-specialist workers is viewed positively. Relative costs and work attitudes were more problematical. From a cost point Vancouver compares favourably with such centres as New York. Hong Kong labour costs, whilst rising quickly, remain substantially below North American levels. A recent analysis published by the Union Bank of Switzerland, and summarized in Table 20, shows that workers in Hong Kong put in the most hours and take the least paid holidays when compared with other major centres. Hours were in excess of 2,600 and paid holidays amounted to 7.6 days annually. This compares with Tokyo at 2,013/6.1, New York 1,867/13.0, Toronto 1,839/17.2 and London 1,754/24.1.

3.9.3 THE LABOUR CLIMATE

* The international shipping industry's perception of the labour climate in British Columbia is generally poor.

This perception arises partially from press coverage, but also from the actual experience of difficulties encountered by owned and managed ships on the British Columbia waterfront. A recent ILO study ranked Canada fifth in the number of working days lost through strikes over the period 1977/86 (at over 600 lost days per thousand employees annually). On this scale, the number of lost days in Canada was less than that experienced in Spain, Italy, Greece and Ireland; it was more than Britain, New Zealand and Australia.

Two specific labour concerns were expressed with respect to locating owning/managing activities in Vancouver:

* the potential unionisation and militancy of office workers, and

* possible action by the International Transport Workers' Federation (ITF) against foreign-flag, foreign-crewed ships calling at Vancouver which are owned or controlled by Canadian-based operators.

3.10 ESTABLISHMENT COSTS

Gross office occupancy costs in Vancouver compare very favourably with those in other international business and shipping centres. At an average estimate of US$ 30 per year Vancouver has the lowest gross occupancy cost figure of the cities compared, and is on the same level as Singapore and Los Angeles. It is substantially less than New York, half that of Hong Kong, one fifth of London and one sixth of Tokyo.

From Table 20, it can be seen that Canadian gross wage costs compare favourably with those in other North American cities, Europe and Japan. The figures shown for Hong Kong and Singapore are not considered representative of the shipping industry - which commands higher wage levels than median occupations. In the specialist shipping occupations, Vancouver does not appear to be substantially more expensive than Hong Kong (probably around 20%); the differential is wider in the low/mid level generalist positions - for example the gross wage cost for a secretary is US$ 18,800 per year in Toronto, compared to US$ 9,200 in Hong Kong and US$ 11,700 in Singapore.

3.11 IMMIGRATION AND WORK PERMITS

The immigration aspects of relocating a shipowning/managing operation to Canada do not appear to create any significant

difficulties. The shipowner and his family can be expected to qualify under the entrepreneurial scheme. The number of key personnel requiring immigation status would be restricted. Single term work permits should ensure continuity where there are competing views on necessity of a person to the operation.

Independent ship management companies have traditionally moved senior seagoing staff in and out of shore-based supervisory positions on a regular basis. Access to work permits becomes a larger factor for this type of organisation, and existing Canadian practices may prove restrictive.

3.12 THE FISCAL REGIME

3.12.1 GENERAL

The capital requirements for investment in shipping assets and the financing of working capital are very large. Charter rates are determined by the international market and are extraordinarily volatile, short term variations of 100% are regular occurrences in some sectors. The underlying asset values tend to reflect the charter market; as a consequence, second hand ship prices move precipitously. The prices of new buildings are relatively stable by comparison, correlating more closely with the cost of factor inputs, though they also exhibit pronounced cyclical movements as the availability of shipbuilding berths changes. At the other end of the life of the asset, scrap prices are cyclical and volatile.

The safest route for a potential shipowner is to build a ship against a very long term charter with a first class principal. Providing the charterer survives over the long term, and/or there is no enforced renegotiation; and subject to the escalation in ship operating costs being in line with forecasts, or alternatively passed on to the charterer; then the project will make long term financial sense. The margins will be extremely slim; only those companies with access to low cost, efficient operating factor inputs, and are constituted in a tax free, tax neutral or tax beneficial environment will be competitive.

On the other hand, the successful shipowner/entrepreneur who is not content to act in the "passive/banker" role above, requires a highly developed sense of timing for asset investment and disposal. He also needs extremely deep pockets and flexible backers (loan institutions and investors) to avoid enforced asset disposal at fire-sale prices.

The imposition of the taxation element introduces an extraneous cost factor which has a significant negative impact on cash flow in a relatively arbitrary way; and this can severely hamper asset acquisition and disposal decisions. As virtually all internationally traded shipping assets are purchased with tax free, tax exempt or pre-tax money, any regime which taxes earnings and capital gains held and used in re-investment, will necessarily be uncompetitive.

The governments of traditional maritime nations have introduced at various times tax driven schemes designed specifically to foster their national flag fleets and/or their shipyard activities. Some of these schemes have proved to be such a major revenue drain, or have created so much distortion that they have either been terminated or restricted very quickly. During the 1970s the U.K. system of 100% first year allowances, free depreciation and group relief was a significant feature in the international popularity of owning U.K. flag vessels. The redirection of capital and depreciation allowances has also been a popular method of providing ship leasing opportunities in a variety of jurisdictions at various times - dependent upon the prevailing rules. Tax shelter partnership schemes, pioneered in Norway and West Germany in the early 1970s, have been instrumental in funnelling large amounts of tax deferred funds into shipping investments in Norway, Denmark and West Germany.

The ability to shelter income (marginally tax rated in excess of 90%) through K/S shipping partnerships has been one of the main reasons behind the recent renaissance of Norwegian shipping. It is estimated that there are 250 partnerships of this kind in Norway, involving 10,000 private individuals, which have generated US$ 3 billion in risk capital for shipping. Approximately half of these funds have been raised over the last 18 months, reflecting the improved competitive position of Norwegian shipping consequent to introduction of the NIS.

Experience worldwide shows that a tax free or tax neutral shipping environment is not of itself sufficient to maintain the competitivity and profitability of a high cost national fleet in unprotected international trades. The last decade under European flags shows that even when the tax system provides a substantial subsidy to the industry, the ships will remain uncompetitive unless owners can also avail themselves of least-cost operating opportunities through offshore crewing.

3.12.2 CANADA - SHIPOWNING

There are very few shipowners based in Canada operating under either Canadian or foreign-flag in the deep-sea international trades.

Canadian vessels are generally uncompetitive in international trades, although some niche marketing (self unloaders and Arctic-technology operations) has been successful on occasion. The uncompetitive position is due to high operating costs and the potential tax take. The Canadian Second Register which has been proposed would remove the taxation element and partially address the high cost of operating with Canadian crew.

Some Canadian shipowners, traditionally Great Lakes operators, are moving into international trades. At least one has major expansion plans in this area - and expects to have 14 ships trading internationally by 1993. As international operations become the predominant source of cargo for the ships involved, these vessels are progressively being flagged-out to offshore registers and manned with foreign crew (eight units to date).

Over the short and medium term, all of these owners will be faced with a situation where taxation will become a cost factor in the operation of these offshore ships. Without relief, the "mind and management" of these ships will also be placed offshore. The timing of these expatriating moves will depend upon the overall tax liability position of the companies involved; a time frame ranging from one to three years is anticipated. This decision will be made on the same grounds as that made by Canadian Pacific in 1964 when, having made the strategic decision to enter into the international bulk trades, it opted to place its mind and management in Bermuda after unproductive discussions with the Canadian government.

3.12.3 CANADA - SHIP CHARTERING

Most of the international ship operating which does take place from within Canada is based on the timechartering of foreign-flag foreign-owned ships from offshore third parties. Much of this activity services the requirements of Canadian exporters engaged in selling commodities on a CIF basis to offshore markets. In some instances, exporters have established their transportation divisions as independent businesses. To varying degrees these transportation subsidiaries engage in the carriage of commodities for other Canadian exporters, and may operate commercially in the Canadian import trades and the international cross trades.

At least one of these operations is placed offshore, and a second one is currently considering moving offshore because of the increasing exposure to Canadian tax liability as markets improve.

Several other Canadian organisations which charter in ships are not part of exporting groups, and are usually closely held. These companies operate mainly in the bulk and neo-bulk parcel trades and engage in other international business as the opportunities arise. In most cases the companies involved stated that the Canadian taxation regime prevented them from expanding their Canadian operations - either in terms of number of ships, or by restricting their activities to timechartering. These companies are onshore either because of the importance of the Canadian market to their business, or because the owner has an overwhelming personal commitment to remaining in Canada.

There are at least two Canadian beneficial owners owning and managing ships offshore through foreign subsidiaries where the vessels are timechartered to an owned Canadian company (on an arms-length basis); this structure separates the fiscal exposure of the shipowning/managing unit (offshore) from that of the commercial/operating unit (onshore). Undoubtedly, this structure results in the duplication of some management functions. It also exposes the operation to detailed tax auditing of the transfer pricing involved.

3.12.4 CANADA - FOREIGN OWNED BRANCH OFFICES

Several foreign shipowners, heavily involved in the Canadian international maritime trades, have branch offices established in western Canada which provide local commercial, operating and ship husbanding functions. In specific instances, Canada is a very significant cargo hub, and one from which a substantial part of their international operations should logically be controlled. Local activities are, however, limited to essential Canadian services in order to ensure that Canadian taxation will not be applied to worldwide income under the "mind and management" test.

In 1988, a foreign shipowner, now operating a service as a substantial cross-trader in a major liner/parcels trade between the west coast of North America and Pacific Basin ports, established the headquarters for the service in a U.S. west coast city. British Columbia provides much of the cargo base for this line. It is understood that the location decision was made reluctantly and on the basis of potential exposure to

Canadian taxation on worldwide income - a comparable exposure to U.S. taxation was not associated with the American location chosen. The office will employ between 30 and 40 shore-based personnel.

It is believed that Canadian taxation may have been a factor in the location of the North American headquarters for other liner and neo-bulk services. This reduced commitment to Canada will obviously be a factor when a liner service is under pressure and a decision has to be taken on whether to serve west coast Canadian ports by transhipment through U.S. ports rather than by making direct calls.

3.12.5 OVERALL

The developing pattern of ship ownership, management and control leads to the conclusion that international shipping requires either a tax free/exempt environment, or one which provides substantial tax subsidies.

It is apparent that any Canadian organisation (exporter or shipping interest) which involves itself in international shipping on a profit generating basis cannot be competitive because of the corporate tax regime. This results in either the avoidance of the business opportunities, or relocation offshore.

For the foreign shipowner or operator, the Canadian taxation system ensures that either his presence in Canada is restricted to the minimum necessary to secure his cargo interests, or any presence in Canada is avoided.

For there to be any future onshore Canadian presence in international shipping, the Canadian corporate fiscal regime must be addressed in such a manner that it is possible to place the "mind and management" of an international shipping business in Canada without exposing the worldwide income of that business to Canadian taxation.

3.12.6 PERSONAL INCOME TAX

Some shipowners (when successful) have changed their country of residency to avoid taxation on their shipping operations and/or their personal income. Certain jurisdictions have provided opportunities to unite both corporate and personal residency in the same location in an effectively tax free environment (e.g. Hong Kong). Others have permitted the accumulation of funds offshore in both corporate and personal

holdings, on the basis that the onshore corporate entity acts as an agent only, and that the individual owner is exempt on the basis of non-residency or through the exclusion of offshore derived income (e.g. United Kingdom).

It should be noted that in many of the jurisdictions examined, in which ship management functions are effectively encouraged by tax exemption or exclusion, the ship management/agency is used as the method of separation of offshore ownership and onshore management of the ship (U.S.A., U.K., and Hong Kong - see Figure 15).

The extent and scope of personal income taxes in Canada was raised as a negative factor by a limited number of people contacted - mainly in Hong Kong. Canadian taxation of worldwide personal income obviously creates difficulties, and a preference was expressed for a taxation regime which assessed offshore earnings on a remittance basis. The potential tax free status of international shipping income, when combined with the taxable status of international, non-shipping, active investment income, created a hypothetical situation which was considered inflexible and therefore unworkable for those with diversified business interests. Several other owners have indicated that, providing the shipping corporation itself was tax exempt in Canada, they would be prepared to reside in Canada and pay Canadian taxation on their personal incomes.

The concept of a tax exempt environment for qualifying shipping corporations based in Canada has considerable merit in terms of strategic implications for exports and in the creation of jobs and economic benefit. It is, however, difficult to see any justification for treating a Canadian resident shipowner in a fundamentally different manner to any other Canadian resident in respect of personal income.

The taxation model proposed by Clarkson Gordon recommended that dividends paid by an ISC directly to a Canadian resident individual would be taxable in the hands of the recipient without special preferences relating to dividend gross-up and credit. Dividends paid to a Canadian resident corporation would be deductible in computing taxable income under specified conditions. The Clarkson Gordon Memorandum went on to suggest that dividends paid to a non-resident shareholder should be exempt from domestic taxation (rather than subject to a withholding tax - reduced by tax treaty or legislation).

It is suggested that the ISC concept as expanded by Clarkson Gordon should permit the owner to place onshore in Canada either:

the corporate beneficial ownership of the vessel
or
the ship management/agency for an offshore owner

This would permit tax exemption for the international shipping operation at the corporate level, whilst the individual owner could either reside in Canada (subject to Canadian personal income tax), or reside offshore (exempt from Canadian income tax).

4. THE SPECTRUM OF OWNERSHIP

The various contracts entered into by the parties to a shipping transaction define the responsibilities for performance, apportionment of costs, and establish authority.

The contract (or charter) regarding the use of the ship results in the charterer appearing as the effective owner to the next contracting party. Hence, when a voyage charter is concluded between the ship operator and cargo interests, the ship operator may be described in the charter party as the "timechartered owner", "disponent owner" (not strictly a correct use of the term), or simply "owner". The ship operator, however, may have sub-timechartered the ship from another sub-charterer (and there may be several levels of sub-charterer). Further up the chartering chain there will be a charter party between the "head timecharterer" and the "owner". The "owner" in turn may have the vessel on bareboat charter from the titled owner. The bareboat charter agreement may involve a "demise" of the ship, in which case the bareboat charterer is legally the "disponent owner".

Bareboat charters are usually longterm arrangements and often involve purchase options or commitments. Timecharters may be longterm, for intermediate periods, or for single trips. Often a charterer with a cargo interest will be in the position to opt for either a trip timecharter or a voyage charter in respect of the same ship. His choice will be dictated by a variety of circumstances usually dictated by the extent of knowledge of the trade of the negotiating parties and how these translate into the estimated cost of freight.

The "ownership spectrum" is shown schematically below:

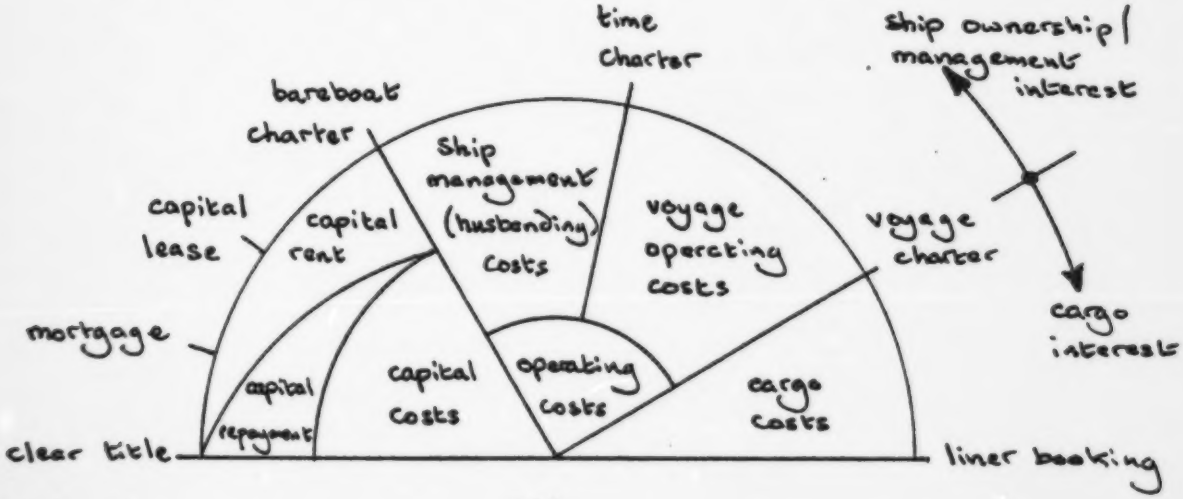


Table 21

The concepts may also be described through an outline of the allocation of the various costs for which the parties are responsible:

CAPITAL COSTS	
repayment of loan principal	)
financing costs	) bareboat owner/lessor
depreciation	)
SHIP MANAGEMENT COSTS	
crewing	)
wages and benefits	)
repatriation	)
victualling	)
repair and maintenance	)
voyage repairs	) timechartered owner
drydockings and surveys	)
insurance and administration	)
hull and machinery	)
Protection & Indemnity	)
registration costs	)
SHIP OPERATING (VOYAGE COSTS)	
oil fuel and diesel	)
pilotage	) timecharterer
port costs	)
CARGO EXPENSES	
loading, discharging, trimming	)
detention of vessel	) voyage charterer

4.1 THE OBJECTIVE AND THE QUALIFYING LIMITS

The objective of this project is to encourage the performance of ship ownership and ship management functions in Canada. The question arises as to how far along the "ownership spectrum" this encouragement should extend.

The Task Force on Deep-sea Shipping recommended a taxation exemption for direct and disponent ownership which did not extend to timechartered ownership. At the other end of the spectrum, the Clarkson Gordon Memorandum suggested that the maximum amount of bareboat chartering permissible in a qualifying company's shipping portfolio be limited to 50%.

With reference to the spectrum diagram, these two suggestions limit the proposed fiscal encouragement to those functions performed to the left of the timecharter line, and place restrictions on the proportion of those functions performed on the extreme left.

A cargo interest, which sells CIF and takes in vessels on a voyage basis with the full control of discharge port operations placed firmly on the buyer (including demurrage responsibility), is not significantly extending its field of activity downstream within the maritime transportation system. Whilst the actual fixture of the freight contract does include an extension of the functions performed by the cargo interest, there is little extension of expertise beyond tidewater. In addition, the freight negotiated is simply part of the cost of sales equation. On this basis, the activity is not one that appears to need specific encouragement.

A cargo interest may negotiate a Contract of Affreightment (COA) covering the shipment of large volumes of cargo over an extended period of time to be shipped on a series of voyages. Under the COA, the shipowner may achieve the specified amount of space or number of voyages by nominating ships which are under his control - whether he owns them, bareboat charters them, timecharters them (on a short or longterm basis), or takes them in on a voyage charter.

Similarly, cargo interests in Canada who participate in CIF sales may have the option of taking ships in on a timechartered or voyage basis. If these transactions are treated as a cost of sales then taxation is not a factor. Many cargo interests in Canada maintain their transportation divisions as profit centres, however. Under these circumstances, the transportation division will probably enter into a COA with the exporting division, and may engage in additional freight agreements with other shippers in the same or different sectors, inside and outside Canada. The transportation division will then secure ships against the contract as set out above. The result is innovative cargo combinations, competitive freight rates, and a reduction in the landed cost of cargo. Under these circumstances, the transportation division is undoubtedly performing ship management and control functions which should be encouraged. The fiscal environment becomes a factor in the way the operation is structured, whether it will be performed at all, and whether or not it is performed in Canada.

The transportation division of one western Canadian exporter is located offshore as an independent shipping company for reasons which undoubtedly include the additional costs of operating from the natural Canadian location. The management of the transportation sector of at least one other major exporter (onshore at present) is actively considering a move offshore consequent to the improving freight markets and the potential impact of taxation on its competitive cost of operations.

There is a strong case for the extension of encouragement to Canadian organisations which take in timechartered ships for operation in third party business (in whole or part), and for organisations in which the transportation division deals with the commodity divisions on an arms length basis.

4.2 THE N.V.O.C.C.

Discussions concerning the cut-off point for any encouraging measures indicated that some parties hold that all activities associated with international shipping activities merited inclusion. It is apparent, however, that many activities which currently take place in Canada do so because they perform functions which are "naturally" onshore within the context of the base trade.

The best example of a (possibly) marginal case involves the Non Vessel Owning Common Carrier (NVOCC). An NVOCC will usually enter into a slot charter (i.e. reserve a certain number of container slots in each ship) with a shipping line offering a regular container service. The slot charter rate will be negotiated at preferential levels. Using either his own containers, or line supplied units, the NVOCC then offers shipping space to his customers. This function is usually combined with CFS consolidation. The development of NVOCC operations is often an expansion of freight forwarding. It does not involve the management or operation of ships in international trade.

As a consequence of the above, it is felt that in order to provide adequate focus, any encouraging measures should be restricted to operations which place the recipient in control of the whole vessel.

5. POTENTIAL TARGET GROUPS

5.1 CANADIAN EXPORTERS

The Canadian exporting community was a major supporter of the International Shipping Centre (ISC) proposal as recommended by the Task Force on Deep-sea Shipping. Seventeen industry associations representing various commodity sectors (forest products, agriculture, sulphur, potash, fertilizer, coal and other mining activities) were members of the Exporters Coalition on Canadian Maritime Policy at that time. This association-of-associations became a leading proponent of the proposal, attracting endorsements from other non-member exporting groups.

Canadian exporters view any move which might retrict their access to international ocean transportation at competitive market rates with considerable alarm. This includes any suggestions of government support for a deep-sea Canadian merchant fleet, with the attendant potential for cargo reservation and other interventionist measures.

The exporters viewed the ISC proposal as follows:

* it did not interfere with their competitive access to marine transportation, and

* it provided them with the option of moving downstream in the ocean transportation function through enhanced

    * CIF terms of sale,
    * chartering activities, and
    * potential ownership of competitive tonnage;

and further, it was a proposal which did not involve any government subsidy (or effective tax loss).

Our interviews with Canadian exporters have demonstrated that this position is unchanged. The extent of CIF sales activity, and the use of ocean transportation as a marketing, and logistical tool has expanded in several sectors over the last ten years. This has been in response to increased competition in the commodity markets, and the need for more aggressive selling.

A discussion of the strategic merit of the control of ocean transport in trade is contained in Appendix 1 to this paper.

Western forest products exporters have maintained their commitment to CIF sales. Although other sectors will not jeopardise a favourable FOB sale through insistence upon the control of ocean freight, there is a fundamental appreciation that marine transportation can be used to secure sales on a landed cost basis - sales that otherwise would not take place at all. The position adopted by some of the larger exporters in the coal, sulphur, potash, fertilizer and other minerals sectors, may be categorised as "sell CIF where possible, unless it jeopardizes the sale".

Major corporations in all of the above mentioned sectors have, at various times in the last eight years, undertaken studies (of varying intensity) involving either the long term timechartering or the purchase of ships for operation under foreign-flag. In each instance, the uncompetitive Canadian taxation of shipping has appeared in the costing analysis. The number of these projects which have actually come to fruition has been few - and the tax element has been a factor (sometimes substantial) in the negative outcome.

The elimination of the impact of taxation is seen to expand the range of options for the exporter who has not moved downstream in this area. Developments would be medium to long term.

Those Canadian exporters currently involved in the marine transportation function on an income generating basis are predominantly in the forest products sector. The uncompetitive fiscal treatment of these shipping activities has resulted in either expatriation or active consideration of an offshore relocation. The improving shipping markets, and the depletion of carried forward tax losses from the recession years, is inducing a short term decision timeframe.

Overall, Canadian exporters represent a substantial target group; in the first instance to maintain onshore presence of existing timechartered operators and to encourage expansion into the shipowning sector. In the longer term, to provide exporters with the option for expansion into profit motivated timechartered ownership and full shipowning in a tax neutral environment.

5.2 CANADIAN-BASED SHIPOWNERS AND OPERATORS

There are a limited number of Canadian shipowners owning and operating foreign-flag tonnage in international trade who are actually based in a Canadian location. Those that are may be

expected to relocate the "mind and management" of these foreign-flag operations offshore within the short and medium term - dependent upon their respective corporate liability to Canadian taxation. From a Canadian standpoint, these owners are an immediate target group. An appropriate change in the fiscal environment would permit these companies to retain management in the existing locations. As the fiscal adjustment contemplated is not a regional one they are not target groups for Vancouver.

There are several Canadian ship operators who bareboat and/or timecharter foreign-flag ships on a period and trip basis for use in neo-bulk and semi-liner services. Those companies contacted have indicated that a substantive fiscal change would result in expansion of operations over the short and medium term.

5.3 CANADIAN OWNED OFFSHORE SHIPOWNERS AND OPERATORS

Those larger Canadian companies, which established substantial shipowning and operating subsidiaries offshore during the 1960s and 1970s, have indicated that they are unlikely to repatriate their operations to Canada - even if a fully tax exempt environment were to be developed. Over the years these organisations have reached the position where the majority of employees are no longer Canadians, and where they have established substantial joint venture operations in ship owning, management and operations. The venues in which they now operate (London, Bermuda, etc.) already provide them with all the fiscal advantages which are under discussion here. Repatriation has little or no attraction under these circumstances.

This negative response suggests that those Canadian companies which are currently contemplating a tax-driven move offshore are unlikely to repatriate once they are well established in the offshore venue.

At least one small owner/operator contacted, who maintains the ownership function offshore, would be a candidate for the repatriation of "mind and management" if a fiscal change was effected.

5.4 U.S. BASED FOREIGN-FLAG SHIPOWNER/OPERATORS

The changes in fiscal treatment of the U.S. beneficially owned foreign-flag fleet will lead to substantial changes over the medium term. New vessels will not be built on a majority

ownership basis to replace sold tonnage. Major charterers (such as the oil companies) will substitute more timechartered tonnage for owned ships. Joint venture partners will be sought, which will permit the companies to avoid the Controlled Foreign Corporation label. This may present opportunities for Canadian shipping investors to become involved with U.S. shipowning companies, but the management of the joint venture can be maintained in America once the U.S. equity interest is reduced to 50%.

The best opportunity for Canada is in targetting entrepreneurial shipowners who are, or were, U.S. based American citizens and who may renounce U.S. cies in order to retain full control of their owned fleets. In these circumstances, Canada would be competing with alternative venues (e.g. Bahamas, Bermuda, etc) but with the advantage of a genuinely North American location.

Foreign-owned shipowners who base their ship management/agency organisations in the U.S. are unaffected by the 1986 U.S. tax reform package, and are not obvious candidates.

Any shipowner who resides in a country which does not conclude a double taxation treaty with the U.S.A. in respect of the 1986 gross revenue/transportation tax, is a likely candidate for relocation. The main outstanding territory is Hong Kong, and an exchange of notes is understood to be imminent. If this does not transpire, then many shipowners in Hong Kong will be forced to relocate to a country which does have an appropriate agreement. This situation should be monitored.

5.5 U.S. BASED FOREIGN-FLAG CRUISE LINES

The majority of the cruise lines operating in the U.S.A. are foreign owned. Any liability to U.S. taxation is limited to the immediate onshore agency/marketing operations conducted in the U.S.A. The U.S. tax regime treats the foreign cruiseship owner in the same manner as other foreign shipowners who operate in the U.S.A. (see above). There is no fiscal reason for such operations to contemplate a tax-driven move to Canada if the fiscal regime is changed.

Vancouver would appear to have significant operating cost advantages for cruise lines based in high cost U.S. cities. The emphasis on marketing and image are such that establishment cost has limited significance in this sector, particularly during the buoyant times this sector is currently enjoying. There will be a long term opportunity in this area, especially for new entrants into the Alaska cruise theatre.

5.6 SCANDINAVIAN AND EUROPEAN SHIPOWNERS

Shipowners who have freight interests in western Canada are candidates for this initiative. For several companies British Columbia is a major cargo hub. Some of these would have already expanded their Canadian based operations beyond regional marketing and operations functions if the fiscal regime had not dictated otherwise. Some of these are managing their operations from high cost locations. They are natural candidates for relocation, and interest has been expressed.

The same reasoning suggests that there are several Japanese bulk operators who may be candidates. Again, some interest has been shown. There is also some suggestion that Japanese liner operators might be interested in expanding their Canadian presence in these circumstances.

There are indications that other European and Scandinavian shipowners, who have potential interests in British Columbia freight opportunities, may be interested in locating some part of their Pacific-oriented operations to Vancouver.

5.7 HONG KONG OWNERS

During the next few years Hong Kong shipowners will be seeking to establish overseas operations either as an insurance policy or in a genuine relocation out of the territory. This also applies to other non-Chinese interests presently located in Hong Kong - specifically Japanese and perhaps others.

The level of interest in Canada is substantial; some Hong Kong Chinese shipowners are naturalised Canadians, own property in western Canada and have family members resident in the Vancouver region. There are some Hong Kong Chinese representative offices based in Vancouver. The proposed fiscal initiative should be sufficient to induce the relocation of the ownership/management/agency functions of a shipowner to Canada - providing his interests are primarily in shipping. If his interests are extensive outside of the shipping sphere, then Canadian residency may be relatively unattractive from an aggregate taxation standpoint - albeit that the ship managing/agency function might still be secured under right circumstances.

Singapore is viewed as the most likely centre to which the Hong Kong interests will locate. There is currently some hesitancy: mainly concerns over medium and long term political stability, plus restrictive elements in the taxation and other systems.

The management of some smaller Hong Kong fleets can be expected to move quite promptly to Canada if the fiscal changes are made - those controlled by entrepreneurial owners wishing to live in Canada. Other owners are more likely to open a small management/agency office in the first instance to "test the water".

Certain comments suggest that there could be some interest in the initiative from Taiwanese shipowners, but this was not explored further.

5.8 GENERAL

The fiscal environment has prevented, and continues to prevent Vancouver from becoming a major international shipping centre.

Neutralisation of the negative taxation issue is sufficient to promote or maintain Canadian activity by Canadian companies:

* exporters,
* existing Canadian shipowners and operators,

It may also encourage

* the repatriation of a limited number of smaller offshore Canadian shipowners.

Neutralisation of the negative taxation issue is not sufficient in itself to attract foreign shipowners and managers, unless these target groups are already attracted to British Columbia and/or they are subject to specific disadvantages where they are currently located.

For several of the main target groups these "pulls" and "pushes" exist, specifically:

* Foreign shipowners with existing and potential freight interests in western Canada - Scandinavian, European and Japanese. High domestic establishment costs in their current locations will also help.

* Companies presently classified as U.S. beneficial owners, who are contemplating severing the U.S. linkage in order to retain full control over their shipping operations.

* Hong Kong owners looking for alternatives as 1997 approaches.

The enthusiasm generated by the investigation has come mainly from individuals and companies which are either predominantly in the Pacific trades, or have a significant Pacific North West cargo base/interest. The majority of interest has been from the bulk shipping sector.

Respect for the confidences granted and commercial sensitivities involved prevents the identification of actual candidates in this paper.

5.9 THE WINDOW OF OPPORTUNITY

An appropriate change in the tax treatment of international shipping will give Vancouver a unique business environment on the American coast of the Pacific Basin, and one which will be competitive with Asian centres - specifically Singapore and Hong Kong. In order to take advantage of the opportunity, the tax changes recommended in the report must take place promptly. A variety of upheavals in international shipping have created an extraordinarily fluid situation which will not last long.

* The major recession in the shipping markets is over, but present earnings are inadequate to justify the new building programmes which will be required if shipowners are to remain in business over the long term. Although cost pressures have eased, shipowners are well aware that they must explore every opportunity to remain cost competitive.

* The national links between the shipowner, the country of corporate domicile, and the country of ship registration have been overturned.

* The political situation in Hong Kong is focussing corporate and individual thinking in Asia on the range of factors involved in a major relocation, and on the alternative venues available. Current immigration to Vancouver provides the city with a unique opportunity in this context.

* Tax reform in Europe and America is quickly eroding the benevolent environments which have been available to shipowners through tax exemptions and subsidies. These changes are driving shipping activity away from some traditional centres to other locations which are internationally competitive.

Concurrent with the international adjustments summarised above, Canada (and British Columbia in particular) has become much more aware of the importance of trade, logistics and the international business environment to its economy and long term development.

* There is a heightened recognition in Canada of the importance of logistics in meeting global competition. This is increasingly apparant in western Canada. Trade with the nations of the Pacific Rim continues to grow in relative importance, and ocean transportation is the predominant factor in the logistical chain.

* Western Canada has become very aware that, in order to develop, it must shift away from the extraction of primary resources into the supply of tertiary services to international markets. Shipowning, operating and management is a major international service industry which fits well within the desired development pattern.

6. ECONOMIC BENEFIT

6.1 SHIPOWNING AND MANAGEMENT - DIRECT EMPLOYMENT

The number of employment positions in a shipowning or ship management office is dependent upon the number, type and complexity of the ships involved, how far along the ownership spectrum the owner/manager opts to go, and the amount of activity taking place in new building design and construction, or second hand purchases.

At one extreme is the shipowner who has an established fleet of ships which are all long term bareboat chartered to a single principal. Under these circumstances, the ownership function is reduced to virtually a book-keeping exercise.

At the other extreme is the cruise line: one which undertakes all of its own sales and marketing; operates its own hotel, catering and ancillary services; and has an extensive newbuilding programme. A shipowner of this type could easily employ 250 shore-based staff in its head office per ship.

Obviously there is a wide variation. Most of the North American and Asian based cargo shipowners and managers interviewed were concentrated in a much narrower band. The average owner operating a fleet of ships between eight and twenty units, predominantly working under period timecharters employs between two and four office personnel per ship. The independent ship manager showed figures less than this - from under one per ship to over two. The ship owning and husbanding functions performed by an independent ship manager are often limited to technical management, crew supervision, supplies and risk management, consequently the shipowner may continue to perform some functions e.g. commercial. Consequently, these low figures can be misleading.

When the shipowner employs his vessels on the spot market rather than period timechartering, the amount of chartering and operating he will have to do increases, and so does the number of staff involved. If the shipowner is extensively involved in downstream commercial activities - operating a bulk parcels service, or a neo-liner or liner service perhaps, extended marketing, operations, insurance, claims, and agency control functions are added, with a consequent increase in essential staff. This example effectively combines the functions of the operator (who timecharter-in the ships) with those of the shipowner (who timecharters-out). Usually a regular service in the bulk and neo-bulk trades will be

maintained using owned and period timechartered ships which will be supplemented by ships chartered-in on a voyage basis - which again expands the functions performed and number of personnel required.

For the purpose of this economic benefit analysis the figure used for the number of on-shore positions generated in the owners/managers office, on a per vessel basis, is four.

6.1.1 SHORT AND MEDIUM TERM PROSPECTS

Based on the level of interest shown (both general and specific responses), and assuming that the Canadian business environment were to be changed appropriately to encourage this activity, it is estimated that a mix of between six and twelve shipowners/managers would either establish offices in Vancouver, or expand existing operations beyond branch agency functions, in the short to medium term. It is forecast that these owners/managers would control some 200 ships from Vancouver, and that this level of activity could be established within two to three years of implementation of the changes.

On this basis, the level of activity forecast would generate some 800 direct jobs and extensive employment opportunities in the industry for people with shipping knowledge or general experience and qualifications. The retention onshore of those existing Vancouver-based timechartered operators currently contemplating a move offshore, as the underlying shipping markets improve, is not included in the above estimate.

This analysis of economic benefit is specific to Vancouver, therefore the benefits of the retention in Canada of the international foreign-flag activities of several eastern Canadian shipowners is not incorporated. A Canada-wide analysis would have to take this into account, in addition to the individual prospects of (say) Montreal or Halifax attracting additional international shipowning and managing activities.

6.2 THE CRITICAL MASS FACTOR

At some point, and dependent on a very wide range of factors, a shipping centre may achieve a certain critical size. At this point additional shipowners, charterers and maritime service functions will establish major branches or relocate there because they cannot afford to be excluded as the opportunities associated with the centre expand. London

continues to exhibit this, in spite of the reduced importance of the British-flag merchant marine and the change in trade patterns.

The more relevant and more recent examples are Hong Kong and Greenwich, Connecticut. In both cases, marine companies continue to move into the area though some of the original underlying reasons for the creation of the centre have disappeared. (e.g. shikumisen deals - Hong Kong, and low establishment costs - Greenwich).

This critical mass concept is particularly important when considering the amount of maritime services which are generated by a shipping centre. As a centre achieves importance, various maritime services will progressively appoint agents, open up a representative office, or move entirely to that location. Once the "market" reaches a certain size, specialist service suppliers will identify the prospects of sufficient business and commit on-site staff and resources.

6.3 THE MARITIME SERVICES SECTOR

In addition to general business services, e.g. legal, accounting, and banking, the shipping community uses a wide range of specialist marine services, these include:

> chartering, and S&P (sale and purchase) broking; ship financing and investment services; insurance broking; P&I services; claims adjustment; marine surveyors; admiralty lawyers; arbitration centres; naval architects and designers; engineering consultants; weather routing services; specialist publications; classification societies; registration offices; etc.

They also purchase internationally large amounts of goods and services. If the market exists in Vancouver, local representatives for these commodities will be appointed, and the business will be transacted locally for offshore supplies. This includes shipyard services (repairs and new buildings); suppliers of marine cranes, containers, and other cargo handling equipment; paints; fuels; and many other items. Opportunities will also increase for local suppliers.

If the business environment permits the shipowner to remit freight and charter income through the Canadian banking system, additional opportunities are generated for banks and financial institutions. Depending on the type, size and age

of the ships involved, two hundred units probably represents a capital investment of some US$ 2 billion with an annual cash flow approaching US$ 1 billion.

The service sector has the potential to become very significant. The study undertaken by the British Maritime Charitable Foundation on the U.K. position, concluded that whilst there were 16,000 jobs in the U.K. based shipowning and management sector, a further 3,000 people were employed in marine technology services, and 15,000 employed in the maritime sectors of commercial services - insurance, financing, ship broking, legal, etc.

The Hong Kong Shipowners Association has recently concluded that the Hong Kong shipowning, management and related maritime services industry employs some 20,000 shore-based staff in the colony (the Association's estimate of the jobs at risk as a result of U.S. tax reform and the absence of a double taxation treaty). It is estimated that the shipowners and managers employ directly between 8,000 and 10,000 people in Hong Kong.

In both instances, there is an indirect:direct ratio in excess of one maritime service job to one direct job. These ratios are for established maritime centres with extensive foreign business.

6.3.1 THE IMPACT ON MARITIME SERVICES - SHORT TERM

In the first instance, the existing maritime services sector in Vancouver would be able to absorb some of the new business generated without substantial expansion. Owners have suggested that they would continue to use many of their traditional suppliers and supply routes in the short term - whilst exploring the quality of locally available services. Shipbroking and legal services would probably feel the new impetus first.

There will be a lead/lag relationship between direct and indirect employment opportunities. Allowing a one year lag interval, it is forecast (based on sectoral estimates) that the amount of shipowning and ship managing which would create some 800 positions over a two/three year period would generate some 200 maritime service positions over a three/four year period.

6.3.2 THE IMPACT ON MARITIME SERVICES - MEDIUM AND LONG TERM

The medium and long term potential is very significant. As Vancouver grows in its context of North America and the

Pacific Basin, as a major international business centre, and as a generator of trade in goods and services, so the amount of international shipowning, management and operating will increase. If the business environment is corrected, and the short term forecasts achieved, then Vancouver could approach the importance of a present Hong Kong or Greenwich over a ten to fifteen year period in this sector. It would then exhibit similar ratios of direct and indirect employment creation.

6.4 ECONOMIC IMPACT

Table 22 sets out the annual economic benefits (at 1988 price levels) which would accrue to Vancouver in Year Three on the basis of the estimates and forecasts derived above. An economic impact multiplier of 2.0 has been used for the direct to indirect/imputed employment, payroll and revenue levels. Maritime services are treated as part of the indirect economic impact.

For the purpose of this estimate the lag relationship between the creation of opportunities in the indirect maritime services sector and the shipowning/managing sector is ignored.

The revenue figures are based on the assumption that shipowning functions based in Vancouver will be largely limited to ship managing/agency operations for beneficial owners, plus timechartered operator functions as appropriate. As a consequence it is assumed that freight and charter hire accruing to the offshore beneficial owner will not pass through the hands of the managing/agent and will have no impact on the local economy. The revenue figures and the indirect and imputed job totals are therefore conservative.

The establishment of Vancouver as a centre for international maritime commerce will compliment and support the growing international trade, banking, finance, and communications sectors. It will assist in achieving Vancouver's aspirations as a comprehensive international business centre and Canada's Asia/Pacific gateway. Easier access to in-depth shipping expertise will allow Canadian exporters and importers greater strategic control of commodity logistics, improving market positioning and minimizing the landed cost of their products. The trade and business centre development aspects will also create economic benefit and generate multiplier effects through the economy. These benefits have not been quantified and are not included in Table 22.

TABLE 22

SUMMARY OF SHORT TERM ESTIMATED ECONOMIC IMPACTS
YEAR THREE (COMPOSITE)

Impact Category	direct	indirect marine services (1)	other indirect & imputed	total
Employment				
Full Time Equivalents	800	200	600	1600
Payroll				
C$ millions	30	9	21	60
Revenues				
C$ millions	72	22	86	180

Note (1) : one year lag relationship ignored

Assumption: solely ship managing/agency operations, freight revenue and hire kept offshore

7. RECOMMENDATIONS

7.1 A REVIEW OF VANCOUVER'S ATTRIBUTES

From the discussion on the previous pages it will be noted that Vancouver has some very major factors working in its favour:

* political stability
* good, competitively priced communications
* an exceptional quality of life
* cultural tolerance
* an excellent North American location for Pacific Basin operations
* a workable time zone
* a substantial regional cargo base
* unrestricted foreign exchange transactions
* access to a base of established maritime services
* a competent general labour pool
* competitive establishment costs
* excellent development prospects

Some of the perceived disadvantages relate to the current stage in Vancouver's development as an international business centre and a regional maritime centre. These include areas where sectoral development is the policy objective contained in the proposed initiative, i.e.

* limited availability of maritime services
* limited supply of specialist labour

and those which are more general in scope:

* shortfalls in international air access, especially trans-border.
* slow and apparently complex routings for international transfers of funds.

An area in which the country and the province have poor international reputations, and one of the major negative perceptions encountered, is

* labour disruption and union militancy

However, the overwhelming factor which has prevented, and will continue to prevent, the establishment of international shipping business in Canada is

* the hostile and internationally uncompetitive fiscal environment.

7.2 RECOMMENDATION 1

A change in the tax rules should be effected to permit the "mind and management" of shipping ventures operating in international trade to be located in Canada on a tax exempt basis. This would create

* a major opportunity for development,
* a significant economic impact, plus
* the provision of strategic support for Canadian offshore trade.

Regional discrimination is not necessary.

A tax model should be developed from the recommendations of the Task Force on Deep-sea shipping, taking appropriate cognizance of the Clarkson Gordon Memorandum and responses (see Appendix ii), and incorporating features to attract foreign shipowners and operators.

The tax exemption should incorporate shipowning; ship management; and the operation of ships chartered under bareboat or time charter which are used by the charterer in the carriage of cargo on a profit-seeking basis for third parties, and for related companies where the transaction is at arms-length.

In order to ensure that shipowners and managers have some assurance of consistent fiscal treatment over the medium term, consideration should be given to providing a lengthy notice period for any contemplated changes, and the "grandfathering" of the exemption.

Following the comments of the Task Force on Deep-sea Shipping, it is concluded that the loss of tax revenue flowing from the implementation of this proposal would be small. The amount of international shipowning and chartering for reward which takes place in Canada is limited. Those companies which operate in these sectors in Canada are now looking at expatriation consequent to a move into profitability and the depletion of existing tax reserves.

The loss of corporate tax revenue can be expected to be offset, or more than offset, by the tax revenue generated by the increase in personal incomes, and from the taxation of the additional business in maritime and other services which will flow from the enhanced economic activity.

The costs of implementing this proposal have not been quantified, and they were specifically not required under the terms of reference.

7.3 RECOMMENDATION 2

An appropriate change in the taxation regime would be sufficient to commence an expansion of activity, but, in order to "jump start" and take full advantage of the opportunity, there is an identifiable, short-term need for a focus for information, education and marketing. The supplementary action recommended by this study is the creation of:

* a Shipping Centre Development Office to be located in Vancouver, for an initial 18/24 month period following the appropriate tax change.

The tasks to be conducted would include:

* the production of informative and detailed descriptive material for distribution to the shipping industry, trade commissions, etc.

* maintaining liaison with target groups and candidates

* providing a focal point for enquiries and information flow

* initiating and directing contact between candidates, advisors and the authorities, as appropriate

* in association with Canadian and provincial private and public bodies, initiating and developing international conferences on shipping related matters to be staged in Vancouver (BIMCO, IMO, INTERTANKO, INTERCARGO, etc.)

Once the ground rules and procedures are established, and it is well known throughout shipping circles that Vancouver is "open for business", the need for this office would diminish. An industry association (either the Chamber of Shipping of British Columbia, or a separate organisation) would then provide the necessary focus. This would be in keeping with the expressed need for a minimum of intervention - which is a major requirement of this industry.

Therefore an 18/24 month lifespan is forecast for this Shipping Centre Development Office.

An outline first year budget follows.

TABLE 23

SHIPPING CENTRE DEVELOPMENT OFFICE

FIRST YEAR BUDGET		C$
Director		100,000
Secretary/Analyst		30,000
Travel & Hospitality		50,000
Promotional Material		20,000
Office Costs		
Rent		30,000
Furniture		20,000
Supplies		10,000
Communications		15,000
Total	C$	275,000

APPENDICES

APPENDIX I

TRADE SUPPORT AND
THE TASK FORCE ON DEEP-SEA SHIPPING - April 1985

A.1 THE RECOMMENDATIONS OF THE TASK FORCE

The Task Force on Deep-Sea Shipping under the Chairmanship of Professor Gunnar Sletmo reported to the Minister of Transport in April 1985. The Task Force consisted of fourteen members drawn from shippers, shipowners, labour representatives and academics. The objective of this exercise was to examine the changing circumstances in the international shipping market, to assess whether Canadian trading interests were being affected detrimentally as a result, and to recommend appropriate responses to these changes.

The Task Force reported as follows:

" RECOMMENDATION 1

" It is recommended that the federal government not take steps towards the establishment of a core deep-sea fleet under Canadian flag."

This represented a continuation of Canadian policy.

The Task Force then went on to advise:

" RECOMMENDATION 2

" It is recommended that Canada, as a major importing and exporting nation with significant reliance on ocean transportation, encourage and strengthen its expertise and interests in international shipping."

The main policy initiative recommended by the Task Force in order to achieve the objective as set out in Recommendation 2, was as follows:

" RECOMMENDATION 3

" It is recommended that the government create a fiscal environment conducive to the establishment and maintenance of international ship management activities in Canada."

In elaborating its reasoning, and prior to making detailed fiscal proposals, the Task Force report continued as follows:

"Economic trends beyond the control of the federal government have led to the disappearance of Canadian flag deep-sea shipping. The government can, however, act forcefully to promote and maintain ship management activities within Canada.

"Presently, managing a shipping corporation from Canada will subject that corporation to Canadian income taxes even if its vessels are operating exclusively in international trade. As a result, Canadian shipowners have found it necessary to take up residence abroad in order to operate in a fiscal environment consistent with the needs of deep-sea shipping.

"Therefore its is recommended that Canadian tax legislation be modified in order to create a more hospitable fiscal environment for the maintenance and development of ship management expertise in Canada...."

The Task Force then went on to provide specific recommendations which are set out in full below:

A.2 INTERNATIONAL SHIPPING CORPORATIONS

"...it is recommended that legislation allowing for the the creation of "International Shipping Corporations" (ISCs) be adopted. Such legislation should include the following elements:

"(i) An ISC would be a Canadian corporation, resident in Canada, with a majority of Canadian resident directors. It would require to be majority owned by Canadian residents, either individuals or corporations. The ISC would be managed in Canada, using resident staff and premises.

"(ii) The ISC could own ships (direct or disponent ownership) registered under any flag, including Canadian, directly or through wholly owned foreign subsidiaries.

"(iii) Provided the ISC earned not less than 90 percent of its income from international shipping operations, including capital gains from the sale of ships, it would not be taxed in Canada on its income. International shipping would be defined as the operation of a ship in international trade as specified in section 248(1) of the Income Tax Act. Such exempt income would include dividends received from wholly owned foreign subsidiaries, providing such subsidiaries were established for the purpose of owning vessels to be used in the business of the ISC.

"(iv) The ISC would be required to file tax returns in Canada and to provide other information as needed to support its status.

"(v) Dividends paid from the ISC to Canadian residents should be taxable in Canada. Dividends paid to non-resident shareholders would be subject to withholding tax in accordance with section 212(2) of the Income Tax Act, or relevant conventions.

"(vi) Rules would be needed to determine the taxation of income if such a corporation ceased to qualify as an ISC."

The report then went on to elaborate on the concept itself and on some of the reasoning behind the ISC:

"It is intended that the fiscal relief recommended above be available irrespective of flag. It would apply to management activities involving titled vessel ownership and disponent ownership (lease or bareboat charters), provided the vessels are engaged in deep-sea international operations. Thus, activities other than ship management, such as freight forwarding, LCL consolidation and inland transportation would not be included in this fiscal relief plan.

"While it is difficult to predict the immediate effect of the implementation of this recommendation, it is believed that its long term effect would be most beneficial. It would provide a clear signal to both shipowners and exporters that they may freely operate and manage ships from Canada under tax considerations similar to those prevailing in the United States and in most European countries where various forms of aid to national shipping have the effect that international shipping pays no or minimal tax.

"The cost of taxes foregone by Canada would be close to nil as the overwhelming majority of activities considered under the above recommendation at the present time escape Canadian taxation by operating "offshore". If there is any loss on this account, it would be insignificant, and can be expected to be more than offset in the long run by personal income and other taxes generated by expanded ship management activities in Canada in the future.

"The establishment of the ISC should not inhibit Canadian companies from owning in whole or in part, shares of foreign companies managing and operating vessels under Canadian or foreign flag."

A.3 TRADE: THE STRATEGIC NEED FOR MARITIME EXPERTISE

The Task Force on Deep-Sea Shipping recommended that Canada adopt policies to encourage and strengthen its expertise and interests in international shipping. The policy vehicle recommended to achieve this objective was the International Shipping Corporation (ISC). The initiative was directly aimed at stimulating the onshore ownership and control of international shipping. In turn, these shipowning and control functions would generate the demand for, and foster the development of, the maritime service sector: including ship acquisition and financing, ship management, ship chartering and brokerage, and marine insurance; as well as admiralty law, insurance claims processing and adjustment, naval architecture and many other specialist service functions.

The expansion of Canada's ocean transportation system was considered desirable in its own right, and advantageous for shippers (exporters and importers) who need to "have unimpeded.... access to an efficient and competitive transportation system of which international shipping is an integral part"; and further, that the "presence of a strong basis of shipping expertise within Canada is essential in order that Canada may respond more effectively and forcefully to the complex and changing international shipping environment and protect its exports and imports".

A.4 THE IMPORTANCE OF TRADE TO THE CANADIAN ECONOMY

The Task Force was very aware of the vital importance of trade to the Canadian economy. It was also responding to the central refrain of "freedom of access to international shipping services at competitive prices", a central theme which was repeated by virtually every company and association involved in the manufacturing, transportation and trading of Canadian exports and imports. As a consequence, the ISC policy which was recommended is one that neither distorts the market in international shipping nor involves any significant national cost or subsidy.

The vital importance of international trade to the Canadian economy cannot be overstated. Using the OECD international comparitive statistics, Canada rates as the seventh largest economy, and ranks tenth on a per capita income basis. Canada ranks twelth in terms of international trade relative to its economy (some 46%), and tenth on the basis of per capita trade (some $8,200 annually per person). Whilst these figures do not seem very startling on the surface, the relative importance of international trade to Canada when compared to several major international competitiors is very significant:

INTERNATIONAL RANKINGS:
OECD Statistics - 1987

	GDP rank	GDP /cap rank	trade: GDP % %	trade /GDP rank	trade /cap rank
United States	1	2	14.0	24	19
Japan	2	6	17.3	23	19
United Kingdom	6	17	42.6	16	14
Canada	7	10	46.2	12	10
Australia	10	16	27.8	21	17

Ocean transport is a vital factor in all of Canada's trade with other continents, and is also significant in some of the trade taking place with the U.S.A.

A.5 CIF VERSUS FOB SALES CONTRACTS

The availability of expertise in maritime transportation permits the exporter (or importer) the option of using ocean freight as a marketing and logistical tool in his negotiation of the sales contract. Access to knowledge of ocean freight reduces the level of risk which is involved in the exporter agreeing a CIF sale (or the importer an FOB purchase).

Under CIF terms (Cost, Insurance and Freight) the seller delivers the goods at his expense to a dock in the buyer's port. FOB shipments (Free On Board) are those which are accepted by the buyer of the goods at the seller's port. These INCOTERMS terms define which party to the contract is responsible for each of the various aspects of the process of shipment, such as documentation, bills of lading, licenses, customs clearances, packing, stevedoring, dues, taxes and freight. The CIF seller or the FOB buyer is the party controlling the ocean freight. The two methods have perceived advantages and disadvantages and different Canadian exporters and importers attach varying levels of importance to them. The Western Transportation Advisory Council (WESTAC) conducted a detailed review of the relative merits of CIF and FOB Pricing in a January 1978 paper (CIF and FOB Pricing of Western Canadian Export Products), and the summary is reproduced in Table 24.

Upon examination, the various arguments concerning FOB and CIF in a competitive framework reduce to four:

LOGISTICAL: The ability to rationalize the production and transportation chain by moving downstream in the maritime function. This is closely related to system economies of scale. Inventory control is a major aspect (and may also relate to marketing).

MARKETING: The use of the control of marine transportation as a marketing tool as part of the sales negotiation

RISK: The preparedness to accept risks associated with downstream control.

KNOWLEDGE: The absence of knowledge increases the risk.

Access to maritime expertise provides the necessary knowledge to reduce the risks associated with the control of ocean freight, this allows the exporter to take advantage of the logistical and marketing advantages which are available.

> " ...The interest of the trading parties in the control of transportation is derived from their competitive interests in cost reduction, pricing policy and selling effort. While many specific conditions influence these interests, they are categorized here as the aspect of logistics which affect the opportunities for cost reduction and affect market strategy." [Terms of Shipment and Efficiency in Overseas Trade, Journal of Maritime Policy and Management 1981: Heaver, Taplin and Aandahl]:

Even if the exporter does not decide to take control of the ocean transport, he should still have access to the expertise:

> " A firm active in international trade should protect its interests by being knowledgeable about logistics costs. This requires continual attention to shipping markets even if actual control of shipping is not practised." [ibid.]

Comparing the results of our interviews with Canadian exporters with the findings of WESTAC (1978) and UBC (1981) suggests that the amount of CIF business transacted in Western Canada has increased over the last ten years. Shipments of forest products have traditionally been CIF, and this continues with some minor exceptions. Exporters of sulphur, potash and coal have expanded their levels of CIF shipments and are now more prepared to use shipping as a marketing

tool. As a consequence there is a heightened awareness of the marine activity and increased support for the ISC initiative.

In some traditional markets where FOB terms are long established, buyers continue to be in a position to exercise considerable pressure during price negotiations by using the control of shipping as tool. It does not take long for the inland sector (terminals, railroads and mines) in a high throughput bulk transportation system to become congested when vessels which have been nominated to lift cargoes do not arrive at the terminal. The resulting threat of a system shut down, including the mine itself, is a powerful lever.

TABLE 24/1

IMPLICATIONS OF CIF VS FOB
MESTAC January 1978

1. ADVANTAGES OF CIF	2. DISADVANTAGES OF CIF
PROPONENTS OF CIF SHIPPING CLAIM A NUMBER OF BENEFITS ATTRIBUTABLE TO THIS METHOD OF TRADE:	IN RETURN FOR ANY GROUP OF "ADVANTAGES", THERE ARE COUNTERVAILING FACTORS TO TAKE INTO ACCOUNT:
Gives the shipper better detailed knowledge of real ocean-shipping costs, therefore a better negotiating position when selling his product to overseas buyers.	Increased responsibility for safe distant delivery of the product; added risk factors may arise in unfamiliar areas (e.g. despite contract, the shipper may have problems with demurrage, or other hassles in a foreign port - problems which may not be entirely accidental, such as collusion between customs officials, buyer, ship's captain, etc.).
Rationalization of delivery ports can be organized from the shipper's side rather than the buyer's (e.g. from 27 to 2 in the UK forest products trade); consolidation of shipments and ports in this way may also give customers better service and frequency.	The shipper must develop detailed expertise and involvement in shipping, which may be quite foreign to the present operations and staff.
Advantages of volume shipping may be improved for both customers and shipper.	Market resistance will arise from buyers who prefer to look after their own shipping. Where is the point of bluff, or risk of sales loss?
Development of strong overseas distribution system	The need to sell forward involves added exchange rate and credit risks.
Advantageous mixture of long-term and spot charters may be used to reduce average costs.	Questions may arise as to which country the title to the shipment will pass in, with attendant tax liability problems.
Development of new back haul business; the shipper may become a carrier with long-term charters, multi-purpose containers, new trading connections.	
A number of secondary benefits to the seller's economy are said to flow from increased CIF business: more local jobs more tax revenue extra travel and telcom more repair and supply sales more image and visibility increased "invisible earnings" (insurance, fees, etc.)	
It may be a more politically and socially acceptable way of moving Canadian resources (i.e. more Canadian and less foreign control).	
No capital or infrastructure investment is necessarily required to achieve CIF.	

TABLE 24/2

IMPLICATIONS OF CIF VS FOB
WESTAC January 1978

3. ADVANTAGES OF FOB	4. DISADVANTAGES OF FOB
The shipper is relieved of the responsibility for providing shipping space for the cargo, and relieved of risk on marine rate fluctuations and exchange rate fluctuations.	The shipper forgoes the opportunity to profit from favourable shipping rates or exchange rates.
The shipper is relieved of responsibility for safe arrival of cargo in country of destination.	The shipper forfeits an area of knowledge relevant to the delivered price of his product, and therefore relevant to sales negotiations.
The shipper does not have to gear up a new and perhaps unfamiliar area of expertise on his staff.	Foreign buyers, especially state trading organisations, may insist on supplying vessels to port of export, either because they perceive economic advantage for themselves on a straight cost basis, or because there is an apparent employment or utilisation advantage to their economy.
As a generality, FOB shipping may be safer and more convenient, since the disadvantages of CIF do not arise.	The opportunities noted under Item 1 above will therefore not be available, although it should be noted that they would not necessarily all accrue to the shipper anyway.

Source: Western Transportation Advisory Council (WESTAC);
CIF and FOB Pricing of Western Canadian Export Products.

APPENDIX II

B.1 THE TAXATION MODEL AND SUBSEQUENT COMMENTS

The recommendation of the Task Force on Deep-Sea Shipping concerning ISCs was considered further through the commissioning of a MEMORANDUM IN RESPECT OF TAXATION MODEL FOR INTERNATIONAL SHIPPING CORPORATIONS undertaken by Clarkson Gordon for Transport Canada and dated 6 January 1986. The Exporters Coalition on Canadian Maritime Policy was requested by Transport Canada to comment on this document - in its capacity as the body representing most of the exporters' associations with an interest in maritime affairs, and being a proponent of the adoption of an ISC-type policy.

It is understood that the ISC concept was the subject of discussion between Transport Canada and the Ministry of Finance in 1986, and that government could not see its way clear to adopting the concept as policy at that time. It should be born in mind, however, that the Task Force proposed the ISC concept in the light of its overall recommendations and in connection with the perceived strategic need to maintain and expand Canadian maritime expertise. It was not within the Task Force's brief to consider the proposal within an economic benefit framework or as a factor in regional development.

The Clarkson Gordon Memorandum looked at the ISC concept in the light of competing tax regimes and specifically in relationship to the U.S.A. The Canadian situation compared unfavourably. The Memorandum then suggested the draft of a tax model as the basis for further discussion. The model drafted made extensive use of precedents existent in Canadian tax law up until 1972 in connection with "foreign business corporations".

It is not the intention here to examine the Tax Model in detail or to comment extensively on the Coalition's response. Some comment is necessary, however, as these two documents do clarify certain issues surrounding the ISC concept.

B.2 PRECEDENTS

The precedent setting nature of the proposed ISC exemption was apparently a major concern for the Ministry of Finance. The Memorandum points out that the treatment of foreign business corporations prior to the 1972 Act, certain measures relating to mining operations, and the measures suggested (and now

partially) implemented for international banking services are established precedents. It goes on to state:

> * With respect to recent proposals related to international banking and finance, we would note only that, in contrast to the diversity and magnitude of international banking and financial services, international shipping is such an identifiable and distinct industry that it is difficult to compare the two. The concept of international shipping and the requirement for special measures related thereto is already recognized and established in the Canadian tax system. (Para 81(1)(c) of the Act, and definition of international traffic in subsection 248(1) of the Act")

With respect to the International Finance Centre legislation (Income Tax Act 33.1), it should be noted at this point that the ISC proposal was not, and is not, regional in scope. Having met whatever qualifications are required, an ISC would be able to locate anywhere in Canada. It is probable, however, that ISCs would naturally devolve upon the main regional maritime centres (Vancouver and Montreal, and other locations in the Maritimes and Ontario).

It should also be noted that unlike the British Columbia International Financial Business (Tax Refund) Act the ISC concept does not involve the refund of personal income taxes to personnel engaged onshore in an international business capacity.

B.3 THE EXTENT OF CANADIAN CONTENT

All parties to the discussion agreed that the changes contemplated should not allow the formation of "brass plate" entities which would be able to avail themselves of the Canadian tax exemption without establishing a significant presence in Canada.

The Task force envisaged that an ISC should be incorporated under the laws of Canada. This was considered restrictive by Clarkson Gordon, as it could inhibit the transfer to Canada of existing offshore shipping operations by foreign owners - especially as regards the transfer and assignment of ships, charters mortgages, insurance policies, etc. The Memorandum went on to suggest that a foreign corporation should be able to simply relocate its residency to Canada in order to qualify as an ISC. The requirement for incorporation under the laws of Canada was, therefore, excluded from the Tax Model.

The Memorandum suggested that the Task Force's requirement for majority Canadian ownership in an ISC was also unduly restrictive, and excluded it from the Tax Model. It maintained the requirement that the ISC should have a majority of resident directors.

The Memorandum envisaged that the central management of an ISC must be in Canada for it to qualify, and that the effective test would require 75% of salaries, wages and management fees (other than crew costs) should be paid to Canadian residents.

The Exporters Coalition discussed the whole concept of the onshore presence required to qualify in its paper, and suggested that the appropriate test for qualification should be the presence of the ISC's "mind and management" in Canada (i.e. deemed Canadian residency).

> " ..if sufficient control of the organisation exists in Canada that it would be subject to Canadian taxation under the "mind and management" test, then sufficient control exists in Canada to allow it to qualify for ISC status. Among other things, this would:
>
> > " Allow sufficient flexibility in organisation to accommodate the realities of international shipping and the evolving structure of the international joint ventures in shipping.
> >
> > " Prevent "brass plates on office doors" from qualifying for ISC status.
> >
> > " Ensure that employment and activity which did develop would have a solid basis in economics (rather than taxation) and would have the greatest likelihood of being sustainable in the long run."
> >
> > " Provide a set of rules which are consistent with other provisions in the income tax act and in which a reasonable body of precedent exists."
>
> (Exporter' Coalition on Canadian Maritime Policy: 14 August 1986 letter to Transport Canada).

APPENDIX III/1

INTERVIEW LIST

WESTERN CANADIAN ORGANISATIONS AND INDIVIDUALS

personal interviews

Anglo Canadian Shipping Ltd	A D Grimston	President
Bulk Export Services Ltd	R A Andrew	
COFI MARITIME TRANSPORTATION COMMITTEE		
Skeena Cellulose Inc	B J Birt	Purchasing/Transportation Director
MacMillan Bloedel Ltd	R J Toporowski	Manager, Transportation Planning
Northwood Pulp and Timber Ltd	A F Murray	Director of Distributuon - Pulp
Eurocan Pulp & Paper Co	R K Manifold	Transportation Manager
COFI	G E Bennet	Vice President, Transportation
Weldwood of Canada Ltd	W H McNulty	Manager, Woodpulp Distribution
Balfour Guthrie Forest Products	B Young	Transportation Manager
CTL Westrans	J Cunningham	President
	L Y Y Zia	
Compass Marine Services Inc	N Y K Chau	
Canadian Tropic Line	J Boukett	
Canpotex Shipping Services	S A Boskov	General Manager
Cansulex Limited	D Peterson	
Canworld Shipping Co Ltd	D J Tanner	Vice President & General Manager
Maple Shipping	A Sears	Vice President & General Manager
Chamber of Shipping of British Columbia	R C Stevens	Executive Director
Cormorant Bulk Carriers Inc	A Gilbert	President
Council of Forest Industries of B.C. (COFI)	G E Bennet	Vice President, Transportation
Employment and Immigration Canada	G Varnai	Manager
Eurocanadian Tankers Ltd	J May	President
Gearbulk Shipping (Canada) Ltd	K Jebsen	
MacMillan Bloedel Ltd	G Adams	Director & General Manager Transportation
	R J Toporowski	Manager Transportation Planning
Canadian Transport Co	J Turpin	General Manager
Maritime Group (Canada) Inc	W H Fallis	President
	N J Gokal	Executive Vice President
	C I Jacobsen	Vice President
Pacific Commerce Line	C L Jacobs	President
Sanko Kisen (USA) Corp	E G Ellis III	Vice President
Seaboard Lumber Sales Co Ltd	C D G Roberts	President & Chief Executive Officer
Seaboard Shipping Co Ltd	M B Bjorndal	Vice President Shipping
Seaspan International Ltd	A Foulis	President
Seaspan Offshore Services Ltd	S O Stokke	Vice President
Star Shipping Canada Ltd	P N Russell	
VANCOUVER PORT CORPORATION	F J MacNaughton	Port Manager & Chief Executive Officer
Strategic Planning Committee	N C Stark	Deputy Port Manager
	D Buggie	Assistant Port Manager, Administration
	T A Shortridge	Assistant Port Manager, Services
	P Clark	Assistant Port Manager, Planning
	B J Duggan	Manager, Corporate Communications
Westar Mining Ltd	T L Garvey	Director Transportation
Westward Shipping Limited	N Fellis	President
Individuals	B Sorenson	
	R Jones	Supercargo

APPENDIX III/2

telephone interviews

Alberta Gas Chemicals	T Park	
British Columbia Maritime Employers Assoc.	R V Wilds	President & Chief Executive Officer
Reed Stenhouse Ltd	P J Meane	Vice President
Sultran	K Doyle	
ICan	K Sarsons	
Individuals	M Cunningham	

EASTERN CANADIAN ORGANISATIONS

personal interviews

Canada Steamship Lines Inc	J F Pitre	Vice President Marine
Canadian Pacific Ltd	R K Ganey	Executive Vice President
	D G Toole	Director Financial Analysis
Consolidated-Bathurst Inc	D J Wallace	Director Transportation
	G F Cooke	Manager Marine Transportation
Dominion Marine Association	T N Hall	President
HEC, University of Montreal	G K Sletmo	Professor
Misener Shipping	D K Gardiner	President
Montreal Shipping Inc	J L Thom	President
M M Paterson & Sons	W C Rattray	Vice President
	C L Patterson	
Noranda Sales Corp Ltd	C M J Hibbeln	Vice President Transportation Services
Saguenay Shipping Ltd	B S McVey	President
	D Falaise	Vice President
The Bank of Nova Scotia	P M Mohr	Senior Economist/Manager
The Gaurdern Group Inc	J E Gaurdern	President
Transport Canada	M Brennan	Associate Assistant Deputy Minister
	D Hinks	Economic Advisor
	G L Zahradnitzky	Special Assistant
	J Kavanagh	Economic Analyst
ULS International Inc	J D Leitch	Chairman
	J B Hartford	Senior Vice President

telephone interviews

Royal Bank	R Gray	General Project Manager - Trade

LONDON

personal interviews

BP Shipping	J Thomas	Fleet Manager
	D Warkman	Planning Manager
Athenian Tankers (UK) ltd	K Schmitt	Director
Ben Line Group	I Skinner	Fleet Manager
Shav & Croft	R Croft	Partner
WESCOL/Wallen Ship Management	J Spruyt	Director

APPENDIX III/3

WESTERN U.S. ORGANISATIONS

personal interviews

Admiral Cruises	A Currie	Senior Vice President & General Manager
American President Lines Ltd	H T Haller	Director Fleet Development Marine Operations
Chevron Shipping Co	T S Wyman	Manager Government & Public Affairs Division
	D C Wolcott	President
Frontier International Shipping	O Mathisen	President
	R B Handel	Vice President
Holland America Line/Westours Inc	A van Noort	Director Nautical Operations
	P Mannheim	
Lasco Shipping Co	J H Henderson	Senior Vice President Operations
	K Levis	President
Stellar International Ltd	S MacDonald	Chairman
Teekay Shipping Co Inc	J M Hood	President
	D Glendinning	Operations Manager
Westwood Shipping Lines	T M Luthy	President
	C A Benson	Vice President Forest Products

telephone interviews

Princess Cruises Inc	S Nielsen	Vice President Operations
Seabourn Cruise Line	W Titus	President
Teekay Shipping Co Inc	Allan Stevens	Vice President Finance

EASTERN U.S. ORGANISATIONS

personal interviews

Citibank N A	W Petas	Vice President
Fairmont Shipping (USA) Ltd	S T Ho	President
Federation of American Controlled Shipping	P J Loree	Chairman
	E A Yourch	Executive Secretary
International Committee of Passenger Lines	J H Reurs	Chairman
Manhattan Shipping Agencies	M S Y Wong	President
Overseas Shipholding Group Inc	M L Feder	Director & Senior Vice President
Maritime Overseas Corp	F DeSalvo	Vice President
Navios Management Inc	L Becker-Levke	Counsel & Manager Administration
OMI Corp	J Goldstein	President
Skaarup Shipping Corp	O Skaarup	
International Marketing Strategies Inc	J R Lawrence	
Stellar Chartering & Brokerage Inc	J E Jakubovski	President

telephone interviews

Chase Manhattan Bank	H Hung	
Moormac Marine Group Ltd	G Thomas	
Stolt-Nielsen Inc	R S Symon	Executive Vice President Shipowning

APPENDIX III/4

HONG KONG

Canadian Pacific Rail	Edwin C H Chan	Manager
Chemical Bank	S W Cheung	Vice President & C.O.O.
Clarkson Gordon	Francis Lee	
Commission for Canada	Alexander Lukie	Senior Counsellor
Commission for Canada	Bernard W H Yeung	Senior Commercial Officer
Commission for Canada	Sylvia Potvin	Trade Commissioner
Denholm Ship Management	John W W Wickham	Managing Director
Eastern Prime Line	Frankie S S Ng	Manager
Eastern Prime Line	M L Wong	Director & G.M.
Fairmont Shipping (HK) Ltd	Linda Ho McAfee	
Fairmont Shipping (HK) Ltd	Robert C F Ho	Chairman
Hong Kong Shipowners Association	Michael Farlie	Director
International Maritime Carriers	Frank W K Tsao	Chairman
International Maritime Carriers	T Ip	Senior Manager
Island Navigation Corporation International	M H Liang	Vice Chairman
Jardine Insurance Brokers	Edward K L Lee	Director & G.M.
Jardine Matheson & Co	Dennis K S Hon	Solicitor
OMS Project Development	G A Briedis	Director & G.M.
Oak Steamship Company Ltd	Steve G Hsu	Chairman & M.D.
Oak Steamship Company Ltd	Trish P F Chan	Manager
Orient Ship Management	A T Radica	Managing Director
P T Andhika Lines	H Bambang Sumantri	Managing Director
Tai Chong Cheang Steamship Co (HK) Ltd	Kenneth Koo	Director
Unique Shipping Agencies	Howard S H Cheng	Managing Director
Valles Steamship Company Ltd	David C C Koo	
Wah Kwong & Co (H.K.) Ltd	Frank S B Chao	President
Wallem & Co	Peter J Cowling	Managing Director
Wallem Ship Management	Asvin K Atre	Managing Director
World Wide Shipping Agency Ltd	Helmut Sohmen	Chairman

TELEPHONE INTERVIEWS CONDUCTED IN HONG KONG

Canadian Pacific Ship Management (HK)	R Elwood	Managing Director

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API/GEN1
7 August 1988

THE ASIA PACIFIC INITIATIVE

VANCOUVER - AN INTERNATIONAL CENTRE FOR MARITIME COMMERCE

The Asia Pacific Initiative Advisory Committee is a private sector group established by the Pacific Council of Ministers to assist in identifying significant economic development initiatives for British Columbia in the Pacific Rim. The Committee, through its Transportation Task Force has been active in several important areas of transportation-related development over the past few months - these have included devolution of the Vancouver International Airport and the initiation of the development of an Electronic Data Interchange (EDI) system for Canada.

The Asia Pacific Initiative has recently awarded a major study on the development of Vancouver as an International Centre for Maritime Commerce to Jonathan Seymour & Associates. The purpose of this document is to ask interested parties for their input and involvement in this study.

At present, there is limited recognition in Canada of the significant economic benefits accruing to a location which provides an attractive base for the ownership, management and operation of foreign flag ships in international trade. These benefits arise from both direct employment and from the expansion of opportunities in the maritime services sector - ship broking, insurance, banking, etc. In addition, the development of local shipping expertise enhances the efficiency with which export and import transactions can be handled. The study will seek to quantify these potential benefits.

Part of the study will seek to establish the aggregate business environment which is most suitable for these ship ownership/ management activities - and to identify those areas in which British Columbia is uncompetitive. Subsequently, a strategic plan will be developed. The plan will address those constraints which presently prevent the formation and expansion of international shipping activities based in British Columbia; it will also consider the enhancement of the positive features which do exist.

Canadian ships and crews would not necessarily be excluded from the development. Inclusion, however, would be based upon

international competitiveness. The exercise is not designed to promote (through cargo reservation or subsidy) the operation of ships under Canadian register or the employment of Canadian seafarers.

Although this study will not be limited to fiscal matters, it will take up one of the main recommendations of the 1985 Report of the Task Force on Deep-Sea Shipping (Transport Canada). The Report recommended that the government create a fiscal environment conducive to the establishment and maintenance of international ship management activities in Canada through the creation of "international shipping corporations" (ISCs) which would be exempt from Canadian taxation.

Many Canadian and overseas organisations have looked at the development of beneficial ship ownership functions based in Canada - and the associated barriers. Some will have very specific views on the subject. Jonathan Seymour and Associates would be most interested to obtain the input of interested parties - either on their own behalf or on behalf of principals. First impressions suggest that the parties who would be particularly interested in the concept include:

* Canadian shipping companies with interests in Canadian-flag and/or foreign-flag tonnage.
* Canadian exporters interested in moving "downstream" in their marine transportation function.
* Foreign-flag American interests - subject to the impact of U.S. tax reform.
* European and Japanese owners looking for off-shore bases to control flagged-out vessels.
* Foreign flag cruise lines with extensive U.S. based establishments.

Organisations and individuals wishing to provide the study team with input and constructive opinions are invited to become involved by telephoning:

Jonathan Seymour	604 263 6541, or
Anne G Burnett	613 234 1879, or
Marian Robson	604 689 2492

Any proprietory information received will be treated on a confidential basis.

The results of this study may help to create an exciting opportunity for British Columbia and Canada, and for their respective maritime communities. Experienced observations are the first step.

Many thanks.

JONATHAN SEYMOUR & ASSOCIATES

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JS/QUESTION
29 July 1988

INTERVIEW FORMAT GUIDE

The OBJECTIVE of these discussions is to solicit information as follows:

(1) what a ship owner needs from a geographical/jurisdictional location in order to position ship owning related functions in that location.

(2) indications concerning the advantages of existing and competing locations.

(3) derivation of what constraints have to removed (and what features need to be enhanced) for Vancouver to achieve a worthwhile position in international ship owning and management functions (foreign-flag, off-shore crewed vessels).

INFORMATION is therefore sought concerning:

The current/future ship owning/operating set up of the company approached:

geographic/jurisdictional separation of ship owning functions:

beneficial ownership, legal ownership, overall control, commercial control, ship management/technical control, operations control.

what factors influence/result in these locational decisions, and their relative importance:

fiscal, expertise (afloat and ashore), marketing, cost control, etc

how have these factors changed over time, what changes are predicted.

Is it feasible to develop through cultivation of a suitable business environment (benign fiscal and other regulatory matters), an international maritime centre aimed at securing location of beneficial ownership, control and management WITHOUT establishing an internationally competitive register?

What are the various matters which have to be addressed in this context?

[SHIPPING COMPANY FORMAT]

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JS/QUESTION
29 July 1988

INTERVIEW

current maritime transportation set up

FOB/C&F
when/why

extent of control of shipping at present/historically/future

perception

is downstream marine transportation desirable generally for your organisation/industry? why?

under the right circumstances?

what circumstances?

Any changes in trading environment which might suggest a need to move downstream in distribution chain?

What aspects would you like to control if constraints removed?

chartering? ownership? ship management?

What constraints exist in the Vancouver/B.C./Canadian environment?

How could/should they be addressed?

What are the positive factors?

[FORMAT USED FOR EXPORTERS]

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GLOSSARY/1

Bareboat charter	Ship hire contract/lease. Charterer supplies the crew and maintains the vessel.
Beneficial owner	Shipowner receiving the benefits or profits from the operation of a ship
CDS	Construction Differential Subsidy (U.S.A.) subsidy to a U.S. shipowner intended to equate U.S. new-building prices to world levels.
CFC	Controlled Foreign Corporation (U.S.A.)
CIF	Cost-Insurance-Freight: exporter's price which includes ocean transportation and insurance.
CMA	Connecticut Maritime Association (U.S.A.)
COMMAD	Commission on Merchant Marine & Defense (U.S.A.)
Cabotage	Reservation of a country's coastal or domestic shipping to its national flag vessels.
Dependent Register	Ship register based in a dependency, colony, or territory. e.g. Isle of Man (U.K.), and Netherland Antilles (the Netherlands).
Dual Registration	Registration of a vessel in two national ship-registers, also Bareboat Charter Registration
dwt	Deadweight tonnage: gross lifting capacity (ship or fleet) in weight tons (or tonnes). Strictly, weight of cargo, stores, fuel, passengers/crew and effects, when a ship is loaded to its (deepest) summer load line.
EUSC	U.S. Effective Controlled Fleet. Offshore registered ships beneficially owned in the U.S.A. which can be requisitioned by the U.S. government in a national emergency.
FIRA	Federal Investment Review Agency (Canada)
FOB	Free on Board: exporter's price which excludes ocean transportation, but includes loading costs.
FOC	Flag of Convenience - open registers.
Flag	Flag of the country in which a ship is registered.

GLOSSARY/2

Flag-out	Removal of a ship from the national register of the beneficial owner, and re-registration offshore.
grt	Gross register tonnage: gross lifting capacity (ship or fleet) a volume measurement made in accordance with national rules.
HKSOA	Hong Kong Shipowners' Association.
ISC	International Shipping Corporation (Canada) Tax exempt shipping corporation model proposed by the Task Force on Deep-sea Shipping.
ITF	International Transport Workers' Federation.
K/S	Tax shelter partnership for shipping investment - Norway.
MARAD	Maritime Administration (U.S.A.).
NEP	National Energy Policy (Canada).
NIS	Norwegian International Shipregister - Norway's pioneering, second (or parallel), register.
NVOCC	Non Vessel Owning (Operating) Common Carrier.
ODS	Operating Differential Subsidy (U.S.A.).
Open Register	National shipregister which permits non-national shipowners to register ships with a minimum of formality or qualification. Earnings from international shipping are invariably exempt from national taxation.
P & I Club	Protection and Indemnity Club. Shipowners' mutual insurance association - covering mainly third party risks.
Parallel Register	Second or dependent shipregister (which see).
Second Register	National shipregister which usually allows more flexibility to national (and other shipowners) in manning, taxation, etc. when compared with the traditional national shipregister.
T/C	Time-charter. Ship hire contract. Owner supplies crew and maintains vessel.
Title XI	Shipbuilding loan guarantee scheme (U.S.A.).
tonne	Metric ton of 1000 kg (2204 lbs).
UNCTAD	United Nations Conference on Trade and Development.